Paper-13: CORPORATE LAWS AND COMPLIANCE

	Learning objectives	Verbs used	Definition
LEVEL C	KNOWLEDGE What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	COMPREHENSION What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identity	Recognize, establish or select after consideration
		Illustrate	Use an example to describe or explain something
	APPLICATION How you are expected to apply your knowledge	Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
		Tabulate	Arrange in a table
	ANALYSIS How you are expected to analyse the detail of what you have learned	Analyse	Examine in detail the structure of
		Categorise	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
		Construct	Build up or compile
		Prioritise	Place in order of priority or sequence for action
		Produce	Create or bring into existence
	SYNTHESIS How you are expected to utilize the information gathered to reach an optimum conclusion by a process of reasoning	Discuss	Examine in detail by argument
		Interpret	Translate into intelligible or familiar terms
		Decide	To solve or conclude
	EVALUATION How you are expected to use your learning to evaluate, make decisions or recommendations	Advise	Counsel, inform or notify
		Evaluate	Appraise or asses the value of
		Recommend	Propose a course of action

Paper-13: CORPORATE LAWS AND COMPLIANCE

STUDY NOTE 1 – THE COMPANIES ACT:

Question 1:

(a) Board of directors of Sonia Limited passed a resolution for payment of sitting fees to directors and the same was shown as fees due to directors in the balance sheet of the company. Examine whether this provision of fees due to directors in the balance sheet can be considered as an effective enforceable acknowledgement of debt of the company. Answer with reference to Companies Act, 2013.

(b) Advice Suresh Ltd, on the manner of implementing CSR as per Companies Act, 2013.

(c) The promoters of Balaji Producer Company Ltd., proposed to be registered under Section 581C of the Companies Act, 1956 desire to have the information, whether the company be registered with seven individuals?

For part (c) of the above question, provisions relating to Companies Act, 1956 is considered while answering since corresponding sections of Companies Act, 2013 are still not enforced.

Answer:

(a) An entry in the balance sheet showing a debt owed to the creditor amounts to an acknowledgement of liability unless it is shown that authentication was colourable and vitiated for some satisfactory reason [Babulal Rukmanand v Official Liquidator, Bharatpur Oils Mills (Pvt.) Ltd. AIR 1968 Raj 214].

The directors are the agents of the company and therefore it is not competent for the Board to authorise the giving of a definite promise to pay themselves [Re, Coliseum (Borrow) Ltd., (1930) 2 Ch 44]. To the same effect it was held that a balance sheet showing fees due to directors did not amount to an acknowledgement of debt on the ground that it was not competent for the Board of directors to promise to pay themselves since the directors were interested in the matter and were incapable of binding the company by passing any resolution [Tirumalai Iyengar v Official Liquidator(1961) 31 Comp Cas 561].

Therefore, in the given case, the resolution passed by Board of directors for payment of fees to directors and showing of such dues in the balance sheet does not amount to an effective enforceable acknowledgement of debt.

(b) Rule 4 of the Companies (Corporate Social Responsibility Policy) Rules, 2014 makes the following provision with respect to manner of implementation of CSR Policy:

(i) The CSR activities shall be undertaken by the company, as per its stated CSR Policy.

(ii) A company may undertake CSR activities through a registered trust or a registered society or a company established by the company or its holding or subsidiary or associate company, subject to fulfillment of the following 2 conditions:

(1) If such trust, society or company is not established by the company or its holding or subsidiary or associate company, it shall have an established track record of 3 years in undertaking similar programs or projects.
(2) The company has specified the project or programs to be undertaken through these entities, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism.

(iii) A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs.

(iv) Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least 3 financial years but such expenditure including expenditure on administrative overheads, shall not exceed 5% of total CSR expenditure of the company in one financial year.

(c) As per Section 581C of Companies Act, 1956, an application for incorporation of a Producer Company may be made by–

(i) Any ten or more individuals, each of them being a 'producer'; or
(ii) any two or more producer institutions; or
(iii) a combination of ten or more individuals and producer institutions.

Therefore, a producer company cannot be registered with seven individuals.

Question 2:

(a) The agenda for the meeting of the Board of Directors of M/s. Rajen Enterprises Ltd. held on 20-6-2015 for adopting the annual accounts for the year ended 31-03-2015 included an item relating to payment of dividend. At the meeting it became apparent that the profits made during the year ended 31-03-2015 were inadequate to declare dividend. It is intended by the Board that the dividend be declared at the rate of 20%, whereas the dividend was declared by the company @ 10% in each of the past 3 financial years. The company has some accumulated profits earned in previous years, which were transferred to reserves. Advise the company as to how it should go about to achieve the objective to pay dividend at the rate of 20% on the equity shares.

(b) State the provisions of the Companies Act, 2013 regarding inspection by electronic form of the documents kept by the Registrar. Is the electronic form only mode of carrying out inspection or filing of documents?

Answer:

(a) The fundamental principle with respect to payment of dividend is that dividend is to be paid only out of profits. In other words, the dividend can be paid only out of the following sources:

(i) Profits of current financial year

(ii) Undistributed profits of previous financial years, i.e., accumulated profits of previous years

(iii) Moneys provided by the Central Government or State Government in pursuance of a guarantee given by it.

Payment of dividend out of reserves

As per Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014, dividend can be declared out of the profits transferred to the reserves by complying with the following conditions:

(i) The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the 3 years immediately preceding that year.

(ii) The total amount to be drawn from such accumulated profits shall not exceed I/10th of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.

(iii) The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

(iv) The balance of reserves after such withdrawal shall not fall below 15% of its paid up share capital as appearing in the latest audited financial statement.

(v) No company shall declare dividend unless carried over previous losses and depreciation not provided in previous year or years are set off against profit of the company of the current year.

In the present case, the average rate of dividend declared by the company during the preceding 3 financial years is 10%. So, the company cannot distribute dividend at the rate of 20%. However, the company may declare dividend at the rate of 107o subject to fulfillment of all the conditions contained in Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014.

Payment of dividend by utilising credit balance of Profit and Loss Account

Carried forward profits which have not been transferred to the reserves (i.e. credit balance in the Profit and Loss Account) can be utilised for payment of dividend without any restriction. Such utilisation does not amount to declaration to dividend out of reserves.

Thus, the company may declare dividend @ 20% for the year 2014-2015 out of the accumulated profits retained in the Profit and Loss Account without any restriction, and without fulfilling any condition contained in the Companies (Declaration and Payment of Dividend) Rules, 2014.

(b) The provisions relating to inspection of documents by electronic form are contained in section 399, as explained below:

1. Inspection of documents

(a) Any person may inspect any document filed with the Registrar.
(b) Such inspection shall be made by electronic means.
(c) The inspection shall be made in accordance with the rules made in this behalf.
(d) Such fees as may be prescribed shall be payable for each such inspection.

2. Copies or extracts of documents

(a) Any person may require a copy or extract of any document or any part of any other document.
(b) Such copy or extract shall be certified by the Registrar.
(c) Such fees as may be prescribed shall be payable for requiring any copy or extract.

3. Copy or extract to be evidence

(a) A copy or extract certified to be a true copy by the Registrar shall be admissible as evidence in all legal proceedings.
(b) Such copy or extract shall have equal validity as of the original document.

As per section 400, the Central Government may also provide in the rules made under section 398 and section 399 that the electronic form for the purposes specified in these sections shall be exclusive, or in the alternative or in addition to the physical form.

Question 3:

(a) Under provisions of Companies Act, 1956, relating to producer company, examine whether the office of director of such company shall fall vacant in the following circumstances:

(i) X, a Director of ABC Ltd., a producer company has made a default in payment of loan taken from a company and default continues for 60 days.
(ii) Z, a Director of the above company could not call the Annual General Meeting for the company due to some natural calamity occurred three days before the Schedule date.

(b) Examine in the light of the provisions of the Companies Act, 2013 whether the following companies can be considered as "Foreign Companies":

(i) A company incorporated outside India having a share registration office at New Delhi;
(ii) A company incorporated outside India having shareholders who are all Indian Citizens;
(iii) A company incorporated in India but all the shares are held by foreigners.

Also examine whether the above companies can issue Indian Depository Receipts under the provisions of the Companies Act, 2013?

For part (a) of the above question, provisions relating to Companies Act, 1956 is considered while answering since corresponding sections of Companies Act, 2013 are still not enforced.

Answer:

(a) The given problem relates to sections 581Q of the Companies Act, 1956, as discussed below:

Besides other grounds specified under section 581Q, the office of a director of a Producer Company shall become vacant in the following cases:

- Where the Producer Company, in which he is a director, has made a default in repayment of any advances or loans taken from any company or institution or any other person and such default continues for 90 days.
- Where the annual general meeting or extraordinary general meeting of the Producer Company, in which he is a director, is not called in accordance with the provisions of this Act except due to natural calamity or such other reason.

The given problem is answered as under:

(i) The producer company ABC Ltd. has made a default in payment of loan and such default has continued for 60 days.

This does not result in vacation of office of X, since the said default has not continued for 90 days, which is a pre-requisite for vacation of office under section 581Q.

(ii) The Annual General Meeting could not be called due to some natural calamity.

The office of director of Mr. Z does not fall vacant since the reason for non-calling of the general meeting is some natural calamity.

(b) As per Section 2(42) of the Companies Act, 2013, 'foreign company' means any company or body corporate incorporated outside India which -

1. has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
2. conducts any business activity in India in any other manner.

The answer to the given problem is as follows:

(i) A share transfer office or share registration office constitutes a place of business (Section 386 of the Companies Act, 2013). Since, the company incorporated outside India has a share registration office at New Delhi, the company is a foreign company.

(ii) A company incorporated outside India does not become a foreign company by the mere fact that all its shareholders are Indian citizens. Assuming that the company has not established any place of business in India, and the company does not conduct any business activity in India in any other manner, the company is not a foreign company.

(iii) A company incorporated in India is a 'company' within the meaning of Clause (20) of Section 2 of the Companies Act, 2013. It cannot become a foreign company by the mere fact that all the shares of the company are held by foreigners.

Section 390 of the Companies Act, 2013 authorises a company incorporated outside India (whether or not it has established a place of business in India, i.e. whether or not it is a foreign company) to issue Indian Depository Receipts in accordance with the Rules prescribed by the Central Government. Accordingly, -

(i) 'A company incorporated outside India having a share registration office at New Delhi' can issue IDRs in accordance with the Rules prescribed by the Central Government.

(ii) 'A company incorporated outside India having shareholders who are all Indian Citizens' can issue IDRs in accordance with the Rules prescribed by the Central Government.

(iii) 'A company incorporated in India but all the shares are held by foreigners' cannot issue IDR

Question 4:

(a) What are the steps to be taken for winding up in a case, where the company is solvent, but the business for which it was formed has been completed?

(b) Legal representative of a deceased member of a company alleged oppression and mismanagement. He made a complaint to the Company Law Board for relief. The management of the company is of the opinion that the petitioner has no locus standi since he is not a member. The register still shows the name of the deceased as member. Will the representation be entertained by the Company Law Board?

For part (a) and (b) of the above question, provisions relating to Companies Act, 1956 is considered while answering since corresponding sections of Companies Act, 2013 are still not enforced.

Answer:

(a) Where a company is solvent, the preferable course is to opt for members' voluntary winding up. Following procedure shall be adopted for this purpose:

1. Making of declaration of solvency

A 'declaration of solvency' shall be made by the directors. To be effective, the declaration of solvency must fulfill the following conditions:

(a) It shall be made by a majority of the directors or all the directors if there are only 2 directors.

(b) It shall be verified by an affidavit.
(c) The declaration must specify that the directors have made a full enquiry into the affairs of the company. The declaration shall further state -
    (i) that the company has no debts; or
    (ii) the period not exceeding 3 years, within which, in the opinion of directors, the company will be able to pay its debts in full.
(d) It shall be made within 5 weeks immediately preceding the date of passing of the resolution for voluntary winding up.

2. Registration of declaration of solvency

The declaration of solvency shall be registered with the registrar before the date of passing the resolution for voluntary winding up. The declaration shall be accompanied by a copy of the auditor's report on the profit and loss account and balance sheet of the company. The report shall also contain a statement of assets and liabilities of the company as on the latest practicable date immediately before the making of the declaration of solvency.

3. Passing of resolution for voluntary winding up

A general meeting of the company shall be convened and the company shall pass a resolution for voluntary winding up. Ordinary resolution will suffice for this purpose, unless the articles require a special resolution.

Commencement of voluntary winding up (Section 486) - The voluntary winding up shall be deemed to have commenced when the resolution (ordinary or special as the case may be) for voluntary winding up was passed.

4. Advertisement of resolution (Section 485)

Within 14 days of the passing of the resolution for voluntary winding up, a notice of the resolution shall be advertised in the Official Gazette, and also in one newspaper circulating in the district where the registered office of the company is situated.

5. Appointment of liquidators (Section 490)

The members of the company shall appoint one or more liquidators by passing a resolution in the general meeting. Following points need to be noted:

- The meeting shall also fix the remuneration of the liquidator.
- If no remuneration is fixed, the liquidator shall not take charge of his office.
- Remuneration once fixed cannot be increased, even with the sanction of the Court

Body corporate not to be appointed as liquidator - A body corporate shall not be qualified for appointment as liquidator of a company in a voluntary winding up. Any appointment made in contravention of this provision shall be void (Section 513).

6. Notice by liquidator of his appointment

The liquidator shall, within 30 days after his appointment publish in the Official Gazette and deliver to the registrar for registration a notice of his appointment (Section 516).

7. Notice to Income Tax Officer

The liquidator appointed to conduct the voluntary winding up shall give notice of his appointment to the income tax officer. Such notice shall be given within 30 days of his appointment. Thereafter, within 3 months, the income tax officer shall intimate the liquidator the estimated amount to meet the tax liability. The liquidator is required to set aside the amount to meet the tax liability.

(b) The legal representative of a deceased member is entitled to file a petition under sections 397 and 398 of Companies Act, 1956 of the Act for relief against oppression and mismanagement, even though the name of the deceased member is still recorded in the register of members [Worldwide Agencies Pvt. Ltd. and another v Margaret T. Desor and others]. It would be wrong to insist that the name of the legal representative be first put on the register before he can move an application under sections 397 and 398. Therefore, the Company Law Board may entertain the complaint in the given case.

Question 5:

(a) M/s Nisha Multi-specialty Hospital Private Ltd. has two groups of Directors. A dispute arose between the two groups out of which one group controlled the majority of shares. A very serious situation arose in the administration of the company's affairs when the minority group ousted the lawful Board of Directors from the possession and control of the management of the company's factory and workshop. Books of account and statutory records were held by the minority group and consequently the annual accounts could not be prepared for two years. The majority group applied to the CLB under sections 397 and 398 of the Companies Act, 1956. You are required to decide with reference to the provisions of the Said Act, the following issues:

- **(i) Can majority of shareholders apply to the company law board for relief against the oppression by the minority shareholders?**
- **(ii) Whether Company Law Board can grant relief in such circumstances.**

(b) A private company which became a deemed public company retained the matters contained in section 3(l)(iii) of the Companies Act, 1956 in the articles of association. The company was required under the Foreign Exchange Regulation Act, 1973 and a direction issued by the Reserve Bank of India to reduce its foreign shareholding from 60% to 40%. It made an offer of right shares to all existing shareholders but issued shares only to its Indian shareholders. The foreign company, which is a shareholder, contends that non-issue of rights shares to it amounts to 'oppression'.

For part (a) and (b) of the above question, provisions relating to Companies Act, 1956 is considered while answering since corresponding sections of Companies Act, 2013 are still not enforced.

Answer:

(a) The right to make an application is given under section 399. Section 399 specifies the minimum number of members who are eligible to make an application. It nowhere prohibits a majority of members from making the application.

Where the application is made by a majority of members, relief may be granted if the Company Law Board is satisfied that the majority is oppressed and has been rendered completely ineffective by the wrongful acts of a minority group.

There may be oppression where a minority by physical force or other wrongful act ousts the majority, so as to prevent the lawful exercise of their rights as shareholders. As such, where two different registered offices at two different addresses had been set up, that two rival Boards were holding meetings, that the company's business, property and assets had passed on to the unauthorized persons, that unauthorized persons claimed to be the shareholders and directors, the Court held that majority was oppressed [Re, Sindri Iron Foundry Pvt. Ltd. (1964) 34 Comp Cas 510].

The issues raised in the given problem are answered as below:

(i) Application to CLB by majority of shareholders is valid since the right to apply to CLB is not confined to minority shareholders alone; majority may also apply [Re, Sindri Iron Foundry Pvt. Ltd.]. Since, in the given case, the majority is oppressed, the majority of shareholders may apply to the Company Law Board for relief against the oppression by minority shareholders.

(ii) The Company Law Board may grant such relief as it may deem fit in the light of facts and circumstances of the case, in accordance with the provisions of Sections 402, 403, 404 and 407.

(b) Where the issue of shares to foreign shareholders will amount to violation of FERA and directions of RBI, declining to issue shares to foreign shareholders will not amount to oppression [Needle Industries {India) Ltd. v Needle Industries Newey (.India) Holdings Ltd. (1981) 51 Comp Cas 743]. Further, relief may be granted under section 397 only against continuous acts of oppression. Mere isolated acts do not amount to oppression [Shanti Prasad Jain v Kalinga Tubes Ltd. (1965) 35 Comp Cas 351]. Therefore the contention of the foreign company that non-issue of right shares to it amounts to oppression is not correct.

Question 6:

(a) Explain the provisions of Companies Act, 2013 relating to establishment of Serious Fraud Investigation Office

(b) Mr. Rahim was appointed as managing director of Prudential Company Limited in accordance with Schedule V for a period of 5 years with effect from 1st April, 2014 on a remuneration of ₹ 30,00,000 per year. The Board of directors the company propose to increase the remuneration of the managing director to ₹ 40,00,000 per year. Advise the Board of directors about the legal requirements under the Companies Act, 2013 to give effect to the proposal. State whether the increased remuneration can be paid as minimum remuneration in the event of loss or inadequacy of profit.

Answer:

1. **Establishment of SFIO [Section 211(1)]**
   The Central Government shall, by notification, establish an office to be called the Serious Fraud Investigation Office to investigate frauds relating to a company.

2. **Situation until SFIO is set up [Proviso to Section 211(1)1**
   Until the Serious Fraud Investigation Office is established under section 211(1), the Serious Fraud Investigation Office set-up by the Central Government in terms of the Government of India Resolution No. 45011/16/2003-Adm-I, dated the 2nd July, 2003 shall be deemed to be the Serious Fraud Investigation Office for the purpose of this section.

3. **Constitution of SFIO [Section 211(2)]**
   (a) The Serious Fraud Investigation Office shall be headed by a Director.
   (b) It shall consist of such number of experts as the Central Government may deem fit.
   (c) The experts to be appointed in the Serious Fraud Investigation Office shall be the persons of ability, integrity and experience in the following fields:
      (i) Banking
      (ii) Corporate affairs
      (iii) Taxation
      (iv) Forensic audit
      (v) Capital market
      (vi) Information technology
      (vii) Law
      (viii) Such other fields as may be prescribed.

4. **Director of SFIO [Section 211(3)|**
   (a) The Central Government shall appoint a Director in the Serious Fraud Investigation Office. Such appointment shall be made by issue of a notification.
   (b) The Director shall be an officer not below the rank of a Joint Secretary to the Government of India having knowledge and experience in dealing with matters relating to corporate affairs.

5. **Officers and employees of SFIO [Section 211(4)]**

The Central Government may appoint such experts and other officers and employees in the Serious Fraud Investigation Office as it considers necessary for the efficient discharge of its functions under this Act.

6. **Terms and conditions of officers of SFIO [Section 211(5)]**
The terms and conditions of service of Director, experts, and other officers and employees of the Serious Fraud Investigation Office shall be such as may be prescribed.

(b) As per section 197 of Companies Act, 2013, where the proposed increase in remuneration is within the limits laid down in Part II of Schedule V, the company is competent to increase the remuneration of the managerial person without the approval of the Central Government.

As per Section II of Part II of Schedule V, in the absence or inadequacy of profits, a company having an effective capital of less than ₹ 5 crore may pay a maximum of ₹ 30 lakh as the managerial remuneration. However, if the effective capital of the company is ₹ 5 crore or more but less than ₹ 100 crore, the maximum remuneration shall not exceed ₹ 42 lakh. However, these limits shall be doubled, if the resolution passed by the shareholders is a special resolution.

In the present case, the effective capital of the company is not given. In case the effective capital of the company is ₹ 5 crore or more, then, Mr. Rahim may be paid remuneration of ₹ 40 lakh without passing special resolution. However, if the effective capital of the company is less than ₹ 5 crore, then, remuneration of ₹ 40 lakh may be paid to Mr. Rahim by passing a special resolution.

Question 7:

(a) Examine whether the payment of following remuneration to non-executive directors (directors who are neither in the whole-time employment of the company nor managing director) is in accordance with the provisions of the Companies Act, 2013:
"Sitting fee payable to directors is increased from ₹ 30,000 to ₹ 60,000 per meeting by amending the articles of association."

(b) A public company wants to include the following clause in its articles of association:

"Each director shall be entitled to be paid out of the funds of the company for attending meetings of the Board or a committee thereof including adjourned meetings such sum as sitting fees as shall be determined from time to time by the directors, but not exceeding a sum of ₹ 1,50,000 for each such meeting to be attended by the director."
You are required to advise the Company as to the validity of such a clause and the correct legal position, in the light of Companies Act, 2013

Answer:

(a) As per first proviso to section 197(5) of Companies Act, 2013 sitting fees payable to a director shall not exceed such sum as may be prescribed. Thus, where the sitting fees, as increased, do not exceed the prescribed limit, the approval of the Central Government is not required. As per Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the sum prescribed is ₹ 1 Lakh for every meeting of the Board or any committee of the Board.

In the present case it is proposed to increase the sitting fees payable to directors from ₹ 30,000 to ₹ 60,000 per meeting. Since, the amount proposed is within the ceiling limits prescribed, such increase does not require the approval of the Central Government.

Therefore, the alteration of articles is valid and effectual and so the directors may be paid a sitting fee of ₹ 60,000 for every Board meeting.

(b) The provisions relating to payment of sitting fees to the directors are contained in section 197(2) of Companies Act, 2013 read with Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014. Following points are worth noting regarding payment of sitting fees to directors:

(i) Sitting fees may be paid to a director for attending a Board meeting as well as for attending a meeting of a committee of directors.
(ii) Sitting fees may be paid whether or not the meeting proceeds to business or is adjourned for want of quorum or any other reason.
(iii) The amount of sitting fees shall not exceed the sum prescribed. As per Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the sum prescribed is ₹ 1 Lakh for every meeting of the Board or any committee of the Board.
(iv) If the amount of sitting fees received by any director exceeds the prescribed sum, he shall refund to the company such excess amount. The company shall not waive recovery of such excess amount unless permitted by the Central Government.

The effect of the proposed clause relating to payment of sitting fees is discussed as under:

(i) The proposed clause purports payment of sitting fees at the rate of ₹ 1,50,000 per meeting. Since the amount proposed exceeds the prescribed sum of ₹ 1,00,000 per meeting, it is not valid.
(ii) It is permissible to pay sitting fees for attending a meeting of a committee of directors.
(iii) Where a Board meeting is adjourned for want of quorum or any other reason, the company may pay sitting fees to the directors who attended such Board meeting.

An adjourned meeting is a continuation of the original meeting. Therefore, where a Board meeting is held and is adjourned to a later date, the sitting fees cannot be paid twice, since it is counted as one Board meeting only.

<u>Question 8:</u>

Roshan Limited is a subsidiary of Superfine Machineries Limited. The Board of Directors of the respective companies have made the following appointments on a consolidated monthly salary of ₹ 2,52,000 with effect from 1.6.2014:

(i) Mr. Raj Ahuja, a director of Superfine Machineries Limited, as factory manager of Roshan Limited.

(ii) Mr. Dev Patel, a director of Roshan Limited, as purchase manager of Superfine Machineries Limited.

(iii) Mr. Shiv Raj, relative of a director of Superfine Machineries Limited, as sales manager of Superfine Machineries Limited.

(iv) Mr. Shyam, not related to any director of both the companies, as chief accountant of Superfine Machineries Limited. But his relative has been appointed as additional director of Superfine Machineries Limited with effect from 1.5.1997. Explain the legal requirements to be complied with under the Companies Act, 2013 to give effect to or continuation of the above appointments of employees.

(b) In the light of the conditions laid down under the Companies Act, 2013 examine if the following transaction can reconsidered as a loan to directors:

<u>Answer:</u>

(a) Appointment of any related party to an office or place of profit in the company, its subsidiary company or associate company attracts section 188 of the Companies Act, 2013.

Section 188 requires compliance with the following legal requirements:

1. Consent of the Board is to be obtained by passing a resolution at a Board Meeting.
2. The agenda of the Board meeting in which the approval of the Board is to be obtained shall contain the particulars prescribed under sub-rule (1) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014.
3. If any director is interested in such appointment, he shall not be present at the Board meeting during discussions on such appointment.
4. The appointment shall require the prior approval of the members by a special resolution if the monthly remuneration exceeds ₹ 2,50,000.
5. The explanatory statement annexed to the notice of the general meeting in which the special resolution is to be passed, shall contain the prescribed particulars.
6. If a member is a related party, he shall not vote on such special resolution.
7. The term 'office or place of profit' is defined under Explanation to sub-section (1) of section 188, as follows:

   (a) An office or place held by a director is an office or place of profit if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director.

(b) An office or place held by a person other than a director is an office or place of profit if such person receives from the company anything by way of remuneration.

The given problem:

The answer to the given problem is given as under:

(i) Roshan Limited is the subsidiary company of Superfine Machineries Limited. Mr. Raj Ahuja is the director of Superfine Machineries Limited. As per Clause (76) of section (2), a director of a company is a related party. Therefore, appointment of Mr. Raj Ahuja as a factory manager of Roshan Limited amounts to appointment of a related party to an office or place of profit in the subsidiary company, thus attracting the provisions of section 188. Such appointment also requires the prior approval of the members by passing a special resolution since the monthly remuneration exceeds ₹ 2,50,000.

Thus, the appointment of Mr. Raj Ahuja as a factory manager of Roshan Limited at a monthly remuneration of ₹ 2,52,000 requires compliance with legal requirements as stated earlier in Points 1 to 6.

(ii) Mr. Dev Patel is the director of Roshan Limited. As per Clause (76) of section (2), a director of a company is a related party, and so Mr. Rajesh Patel is a related party. He is to be appointed as purchase manager in Superfine Machineries Limited. The appointment of Mr. Dev Patel as purchase manager in Superfine Machineries Limited amounts to appointment of a related party to an office or place of profit in the holding company, which is not covered under section 188. Therefore, the appointment of Mr. Dev Patel does not attract the provisions of section 188. Such appointment can be made without requiring any compliance with any of the legal requirements specified under section 188.

(iii) Mr. Shiv Raj is a relative of a director of Superfine Machineries Limited. As per Clause (76) of section (2), a relative of a director is a related party. He is to be appointed as Sales manager in Superfine Machineries Limited. The appointment of Mr. Shiv Raj as sales manager in Superfine Machineries Limited amounts to appointment of a related party to an office or place of profit in the company, thus attracting the provisions of section 188. Such appointment also requires the prior approval of the members by passing a special resolution since the monthly remuneration exceeds ₹ 2,50,000.

Thus, the appointment of Mr. Shiv Raj as sales manager of Superfine Machineries Limited at a monthly remuneration of ₹ 2,52,000 requires compliance with legal requirements as stated earlier in Points 1 to 6.

(iv) Mr. Shyam is not related to any director at the time of appointment, and so he is not a related party in terms of Clause (76) of section 2. Therefore, his appointment does not attract the provisions of section 188, and so he can be appointed as Chief Accountant in Superfine

Machineries Limited at a monthly remuneration of ₹ 2,52,000 without requiring any compliance with any of the legal requirements specified under section 188.
Subsequent appointment of a relative of Mr. Shyam as a director in Superfine Machineries Limited shall not affect the appointment of Mr. Shyam as Chief Accountant, since the appointment of Mr. Shyam as Chief Accountant was made prior to appointment of his relative as a director. Thus, no compliance with the provisions of section 188 is required even after appointment as a director of relative of Mr. Shyam.

(b) As per section 185 of the Companies Act, 2013, no company shall, directly or indirectly, make a loan to any person specified under section 185 of the Companies Act, 2013. Amongst the persons specified, a firm in which any director or relative of a director is a partner is also covered. Accordingly, loan cannot be made to a firm, in which the director of the company is a partner.

Question 9:

(a) Following is data relating to Prince Company Limited:

Authorised Capital (Equity Shares)	**-**	**₹ 100 crores**
Paid-up Share Capital	**-**	**₹ 40 crores**
General Reserves	**-**	**₹ 20 crores**
Debenture Redemption reserve	**-**	**₹ 10 crores**
Provision for Taxation	**-**	**₹ 5 crores**
Loan (Long Term)	**-**	**₹ 10 crores**
Short-Term Creditors	**-**	**₹ 3 crores**

Board of Directors of the company by a resolution passed at its meeting decide to borrow an additional sum of ₹ 90 crores from the company's Bankers. You being the company's financial advisor, advise the Board of Directors the procedure to be followed as required under the Companies Act, 2013.

(b) A Public Company secures residential accommodation for the use of its managing director by entering into a license arrangement under which the company has to deposit a certain amount with the landlord to secure compliance with the terms of the license agreement. Can it be considered as a loan to a director?

Answer:

(a) The given problem relates to section 180(l)(c) of the Companies Act, 2013.

As per section 180(l)(c) of the Companies Act, 2013, without the prior consent of the members in general meeting by a special resolution, the Board of directors of a company shall not borrow moneys where the borrowings (already made plus proposed) exceed the aggregate of the paid up capital and free reserves. However, temporary loans obtained from the company's bankers in the ordinary course of business shall not be considered as borrowings.

In the given case, paid up capital of the company is ₹ 40 crores and free reserves are ₹ 20 Crores. Debenture Redemption Reserve and Provision for Taxation are not free reserves. The aggregate of paid up capital and free reserves comes to ₹ 60 crores. The company has already borrowed ₹ 10 crores. The amount payable to creditors (₹ 3 crores in the given case) does not amount to borrowings. Thus, further borrowings by the Board, without obtaining the consent of the members by way of a special resolution, shall not exceed ₹ 50 crores. Since, the Board intends to borrow ₹ 90 crores, prior approval of the members by way of a special resolution is required. The special resolution passed by the members shall specify the total amount upto which moneys may be borrowed by the Board.

(b) As per section 185 of the Companies Act, 2013, no company shall, directly or indirectly, make any loan to a director.

In the present case, the company has provided the managing director with a housing accommodation. It does not amount to a loan because of the following reasons:

- The company has not given any deposit or advance to the managing director. The amount deposited with the landlord cannot be said to be an 'indirect loan' to the managing director.
- It is a usual practice to give a security deposit to the landlord with whom a rent or lease agreement is entered into. Thus, the company has made the security deposit on account of bonafide business considerations.
- It is of no concern of the managing director as to the terms on which the company secures residential accommodation for him.

It is the company and not the director who has entered into the lease agreement. Therefore, the company can at anytime use the accommodation for any other purpose and the managing director will have to vacate it, as and when desired by the company.

Question 10:

(a) State with reference to the provisions of the Companies Act, 2013 whether the following companies can make donations (as on 1.12.2014) to political parties and if so the conditions to be complied with in this regard:

(i) Apna Ltd., a government company registered in 2009 wants to donate a sum of ₹ 10 lakhs.
(ii) Eliza Ltd., a public company registered in 2008 wishes to contribute a sum of ₹ 5 lakhs.
(iii) Ruma Ltd., a company incorporated in the year 2014, decides to contribute a sum of ₹ 3 lakhs.

(b) Board meetings were held on 24th November, 2014 and 15th December, 2014. Mr. Rameshwar, who was the chairman of these two Board meetings died on 20th December, 2014, without signing the minutes. How should the minutes be signed and by whom?

(c) The board meeting of Mahi Ltd. was held on 10th May, 2014 at Surat at 11 a.m. At the time of starting the board meeting the number of directors present were 7.The total number of directors were 10. The board transacted ten items in the board meeting. At 12 noon after the completion of four items in the agenda 4 directors left the meeting. Examine the validity of these transactions explaining the relevant provisions of the Companies Act, 2013.

Answer:

(a) As per section 182 of the Companies Act, 2013, a company shall not make a political contribution unless the following conditions are satisfied'.

(i) The company is not a Government company.
(ii) The company has been in existence for 3 or more financial years.
(iii) The aggregate amount of political contribution in a financial year shall not exceed 7.5% of average net profits during immediately preceding 3 financial years.
(iv) The Board shall make a political contribution only by passing a resolution at a Board meeting.
(v) The company shall disclose in its profit and loss account the amount of political contribution and the name of political party to which such amount has been contributed.

In the given case –

(i) Apna is a Government company and so it is prohibited from making any political contribution.

(ii) Eliza Ltd. has been in existence for more than 3 financial years and so it can make a political contribution. However, the contribution of ₹ 5 lakhs can be made only if the company has made average net profits of ₹ 66,66,667 or more {i.e. 5,00,000 x 100/7.5) during immediately preceding 3 financial years. The Board shall make such political contribution only by passing a resolution at a Board meeting. Further, the company shall disclose in its profit and loss account the amount of political contribution and the name of political party to which such amount has been contributed.

(iii) Ruma Ltd. cannot make any political contribution because the company has not been in existence for a period of 3 financial years.

(b) As per section 118, the minutes of a Board meeting may be signed by the chairman of the said meeting or the chairman of the next succeeding meeting. The minutes shall be prepared and signed within 30 days of the conclusion of the Board meeting.

In the present case, the minutes of the meeting held on 24.11.2014 could be signed either by the chairman of the meeting held on 24.11.2014 or by the chairman of the next meeting held on 15.12.2014. Incidentally, the chairman of these two meetings is the same, i.e., Mr. Rameshwar, who has died. The result is that the minutes of the two previous Board meetings, held on 24.11.2014 and 15.12.2014, have remained unsigned. There is no legal provision covering the above situation. Therefore, it is advisable to convene a Board meeting and appoint a chairman who shall be authorised to sign the minutes of both the meetings held on 24.11.2014 and 15.12.2014.

(c) As per section 174(1) of Companies Act, 2013, the quorum for a Board meeting shall be higher of-

(i) l/3rd of total strength (any fraction contained in that one-third shall be rounded off as one); or
(ii) 2 directors.

'Total strength' shall not include directors whose places are vacant.

Quorum has to be present at the time of transacting each and every business. It is not enough that a quorum was present at the commencement of the meeting. Therefore, where quorum is present at the beginning of the meeting, but some of the directors leave the meeting, so that remaining directors do not constitute quorum, any subsequent resolutions will be invalid.

In the given case, total strength is 10. Quorum for the Board meeting held on 10th May, 2014 shall be l/3rd of 10 directors, i.e. 3.33, taken as 4 directors. Since 7 directors were present at the time of commencement of the Board meeting, the Board meeting has been validly held.

However, after transacting 4 items on agenda, 4 directors left, because of which the number of directors present has fallen below the quorum required. Since, quorum is required at the time of transacting each and every business, the remaining 6 agenda items cannot be validly discussed and voted upon. Therefore, resolutions passed in respect of these 6 agenda items are void, and have no legal effect.

Question 11:

(a) The articles of association of a company provided that Rudra will be a permanent director of the company so long as he holds one-third of the issued share capital. A shareholder sends a special notice to the company for removal of the director Rudra in the general meeting by ordinary resolution. Can Rudra be removed from the directorship, as per Companies Act, 2013?

(b) Referring to the provisions of the Companies Act, 2013, examine the validity of the following:
"On the request of bank providing financial assistance the Board of Directors of Priya Limited decides to appoint on its Board Mr. David, as nominee director. Articles of Association of the company do not confer upon the Board of Directors any such power. Further, there is no agreement between the company and the bank for any such nomination."

Answer:

(a) Section 169 of Companies Act, 2013 gives a statutory right to every shareholder to remove a director before the expiry of his term by following the prescribed procedure.

Any provision in the articles that a director shall not be removed, violates the statutory right given to the shareholders, and is ultra vires. The Act as provided by section 6. Section 6 stipulates that the provisions of the Act have an overriding effect on clauses contained in the memorandum, articles or any other agreement if they are not in conformity with the provisions of the Act.

The articles of a company entitled a director to hold office for life. The Court held that section 169 has been enacted to enable the shareholders to exercise control over the directors and therefore the shareholders have been empowered to remove the directors. Therefore, the said permanent director could be removed from the office [Tarlok Chand Khanna v Rajkumar Kapoor (1983) 54 Comp Cas 12].

In the present case, the articles of the company provide that Rudra will be a permanent director of the company so long as he holds l/3rd of the issued share capital. In view of the overriding effect of section 6, this clause is repugnant to section 169 and is therefore void. Thus, Mr. Rudra can be removed under section 169.

(b) As per section 161(3) of the Companies Act, 2013, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement. The provisions of section 161(3) are subject to any provision contained in the articles of the Company.

In the given case, no agreement has been entered into between Priya Limited and the bank providing the financial assistance with respect to appointment of nominee director. Also, no provision contained in any law for the time being in force authorises the appointment of nominee director. Further, the articles of the company do not confer any power on the Board to appoint the nominee directors. Thus, the appointment of Mr. David as nominee director is not valid.

Question 12:

(a) The Board of Directors of Adi Limited appointed Mr. Nayan as an alternate director a period of two months against a director who has proceeded abroad on leave for a period of six months. Articles of Association of the company are silent. Is the appointment valid as per Companies Act, 2013.

(b) Referring to the provisions of the Companies Act, 2013, examine the validity of the following:

Mr. Pankaj who is not qualified to be appointed as an independent director is appointed by the Board of Directors of Anand Company Limited, for an independent director, as an alternate director.

(c) The Board of Directors of Ruby Ltd. filled up a casual vacancy caused by the death of Mr. Pranay by appointing Mr. Bhanu as a director on 3rd April, 2014. Unfortunately Mr. Bhanu expired on 15th May, 2014 after working about 40 days as a director. The Board now wishes to fill up the casual vacancy by appointing Mrs. Bhanu in the forthcoming meeting of the Board. Advise the Board in this regard.

Answer:

(a) The given problem relates to section 161(2) of the Companies Act, 2013.

As per section 161(2), the Board may appoint an alternate director for a director (termed as original director) during the absence of the original director from India for a period of 3 months or more. The Board may appoint an alternate director only if it is authorised by the articles or by an ordinary resolution passed at a general meeting. The alternate director shall vacate his office when the original director returns back to India.

In view of the provisions of section 161(2), the appointment of Mr. Nayan as an alternate director is not valid since the Board, in the given case, is not authorised to appoint the alternate director by the articles or by a resolution passed in general meeting. Also, the Board is not authorised to appoint an alternate director for any fixed period (2 months in the given case) since the term of office of alternate director has been fixed by the Act, viz. section 161(2), which is upto the date when the original director returns back to India.

(b) As per section 161(2) of Companies Act, 2013, the Board may appoint an alternate director for a director (termed as original director) during the absence of the original director from India for a period of 3 months or more. Section 161(2) also provides that a person can be appointed as an alternate director for an independent director only if he is qualified to be appointed as an independent director as per Section 149(6).

In the given case, the appointment of Mr. Pankaj as an alternate director for an independent director is not valid, since Mr. Pankaj is not qualified to be appointed as an independent director.

(c) As per Section 161(4) of the Companies Act, 2013, the Board is authorised to fill a casual vacancy in the office of a director only if he was appointed by the company in general meeting.

In the given case, a casual vacancy has arisen as a result of death of Mr. Pranay. Assuming that Mr. Pranay was appointed as a director in general meeting, such casual vacancy can be filled up by the Board under section 161(4) of the Companies Act, 2013, and has actually been filled up by appointing Mr. Bhanu.

Afterwards, Mr. Bhanu dies. The death of Mr. Bhanu also results in a casual vacancy. However, this casual vacancy cannot be filled up by the Board under section 161(4) of the Companies Act, 2013 since the casual vacancy has arisen in the office of Mr. Bhanu who was not appointed in general meeting. Accordingly, the proposal of the Board to appoint Mrs. Bhanu to fill the casual vacancy in the office of Mr. Bhanu is not valid.

The Board is advised to appoint Mrs. Bhanu as an additional director under section 161(1) of the Companies Act, 2013, if so authorised by the articles. As additional director, Mrs. Bhanu shall hold office till the next annual general meeting.

Question 13:

(a) Mr. Suresh, an additional director appointed by the board of directors of a public company, is proposed to be appointed as a regular director in the Annual General Meeting. Explain the requirements under the Companies Act, 2013 to give effect to the proposed appointment.

(b) What actions may be taken in pursuance of Inspector's report on investigation, as per Companies Act, 2013?

Answer:

(a) 'Retiring director' for the purpose of sections 152 and 160 of the Companies Act, 2013, means a director retiring by rotation [Explanation to section 152(7)]. Where a director retires by rotation, he can be reappointed without complying with the requirements of section 160 of the Companies Act, 2013 [Section 152(6)(e)].

However, an additional director holds office upto the date of next annual general meeting (Section 161(1) of the Companies Act, 2013), i.e. he does not retire by rotation. Therefore, if an additional director seeks appointment as a regular director, he must comply with the requirements of section 160.

Following requirements shall be complied with:

1. Requirements of notice

(a) Notice proposing the appointment of additional director must be given to the company either by the additional director himself or by some other member of the company.
(b) Notice shall be given at least 14 days before the annual general meeting.
(c) Notice shall be deposited at the registered office of the company.
(d) A sum of ₹ 1 lakh shall be deposited along with the notice.

(e) The amount deposited with the company shall be refunded, if the person proposed as a director –
   (i) gets elected as a director; or
   (ii) gets more than 25% of the total valid votes cast (whether on a show of hands or on poll).

2. Duty of the company to inform its members

The company shall inform its members about the candidature of the person proposed as a director in such manner as may be prescribed.

(b)

1. Prosecution (Section 224(1)]

(a) If, from an inspector's report, it appears to the Central Government that any person is guilty of any offence for which he is criminally liable, the Central Government may prosecute such person for the offence.
(b) It shall be the duty of all officers and other employees of the company or body corporate to give the Central Government the necessary assistance in connection with the prosecution.

2. Recovery of damages or property [Section 224(3)]

If from an inspector's report, it appears to the Central Government that proceedings ought, in the public interest, to be brought by the company or anybody corporate whose affairs have been investigated under this Chapter -

(a) for the recovery of damages in respect of any fraud, misfeasance or other misconduct in connection with the promotion or formation, or the management of the affairs, of such company or body corporate; or

(b) for the recovery of any property of such company or body corporate which has been misapplied or wrongfully retained, the Central Government may itself bring proceedings for winding up in the name of such company or body corporate.

3. Indemnity to CG |Section 224(4)]

The Central Government shall be indemnified by such company or body corporate against any costs or expenses incurred by it in. or in connection with any proceedings for winding up of the company.

<u>STUDY NOTE 2 – LAWS AND PROCEDURES FOR CORPORATE RESTRUCTURING:</u>

<u>Question 14:</u>

(a) Examine with reference to the provisions of the Companies Act, 1956 the validity of the following:

- **(i) A scheme provides for amalgamation of a 'foreign company' with a company registered under the Companies Act, 1956.**
- **(ii) The statement forwarded with the notice convening a meeting of its members pursuant to Court's direction under Section 391 contains only 'exchange ratio' without details of its calculation.**
- **(iii) At the time of filing of the petition for amalgamation, the object clause of both the transferor and transferee Companies does not contain power to amalgamate.**

(b) Explain the term 'arrangement'.

For part (a) and (b) of the above question, provisions relating to Companies Act, 1956 is considered while answering since corresponding sections of Companies Act, 2013 are still not enforced.

<u>Answer:</u>

(a)

(i) For effecting amalgamation of two or more companies, *an* application shall be made to the Court under section 391 (Section 394). The benefit of section 394 is available only if the transferee company (i.e., new company) is a company within the meaning of Companies Act, 1956. However, the transferor company may be anybody corporate, whether a company within the meaning of the Companies Act, 1956 or not. *As* such, a foreign company can be a 'transferor company' but not a 'transferee company'. Therefore, a scheme of amalgamation may provide for transfer of foreign companies to Indian companies.

(ii) For effecting amalgamation of two or more companies, an application shall be made to the Court under section 391 (Section 394). *On* receipt of such an application, the Court may order that a meeting of the creditors or members or any class of them be called, held and conducted in the manner directed by the Court. Where a meeting of creditors or members is called, the notice given to them must contain -

- the terms of the compromise or arrangement;
- an explanatory statement explaining the effect of the compromise or arrangement;
- a statement explaining any material interests of the directors, managing director, or manager of the company. The effect of those interests on the scheme should be explained stating if and how their interests *are* different from the like interests of other persons; and
- if the debentureholders are also affected by the scheme, the interest of the trustees should also be similarly disclosed.

In the present case, the notice convening a meeting of members contains only 'exchange ratio' without details of its calculation. *As* is evident, the terms of the compromise or arrangement have not been disclosed. Therefore, the notice given to members is not valid.

(iii) The memorandum of association explains the scope of operations of a company beyond which the company cannot go. Anything done by a company outside the objects clause of memorandum is ultra vires the company.

However, to amalgamate with another company is a power of the company, and not an object of the company. Therefore, no power to amalgamate is required in the memorandum of a company before making an application to the Court for effecting amalgamation. Also, the power to amalgamate has been given by the statute under section 394. Since there is a statutory provision dealing with amalgamation of companies (which does not require that such a provision must be present in the memorandum or articles of the company), no special power in the objects clause of the memorandum is necessary for its amalgamation with another company. Section 394 is a complete code which gives full jurisdiction to the Court to sanction amalgamation of companies, even though there may be no power in the objects clause of memorandum [Re, EITA India Ltd., AIR 1997 Cal 208; United Bank of India v United India Credit d Development Co. Ltd. (1977) 47 Comp Cas 689, 730 (Cal)].

(b) Arrangement involves a readjustment of the rights and liabilities of the members or creditors or any class of them. There need not be any dispute for an 'arrangement'. The term is wider in scope than the word 'compromise'. It includes any form of internal reorganisation of the company or its affairs, as well as scheme for amalgamation of two or more companies. A few examples of arrangement are as follows:

(i) Issue of fully paid up shares to pay off debentures.
(ii) Creditors agreeing to waive a part of their dues.
(iii) Preference shareholders surrendering their right of arrears of dividend.
(iv) Exchange of company's assets for shares in a newly formed company.

Arrangement includes reorganisiation of the share capital of the company. It includes the following methods:
(i) the consolidation of shares of different classes; or
(ii) the division of shares into shares of different classes; or
(iii) both these methods.

The words 'compromise' and 'arrangement' imply that both the parties make concessions and give up something. A total surrender of the rights by one party would not amount to a compromise or arrangement. As such, where it was proposed that members should abandon all their rights without any compensating advantage, it was held not to be a compromise or arrangement and hence the Court had no jurisdiction to sanction it [Re, N.F.U. Development Trust Ltd (1972) 1 WLR 1548].

<u>Question 15:</u>

(a) M/s Moonlit Consultants Ltd. had, in the course of its operations over the years acquired various other ventures like plantations and tourism businesses. With a view to consolidate its core business activities, the management decided to hive off its non-core activities by demerging them with an associate company. Advise, with reference to Companies Act, 1956 briefly the steps the management should take to achieve the purpose of demerger.

(b) At the time of filing of the petition for amalgamation, the object clause of both the transferor and transferee Companies does not contain power to amalgamate. Comment on the statement, based on Companies Act, 1956.

For part (a) and (b) of the above question, provisions relating to Companies Act, 1956 is considered while answering since corresponding sections of Companies Act, 2013 are still not enforced.

Answer:

(a) For effecting the reconstruction of a company, the provisions of section 394 of Companies Act, 1956 need to be complied with. Section 394 requires that an application shall be made to the Court under section 391 (under section 391, an application is made to the Court for entering into a compromise or arrangement). Since, demerger is also a kind of reconstruction, M/s Moonlit Consultants Ltd may demerge its plantation and tourism business by complying with the provisions of section 394, which are as under:

1. Moonlit Consultants Ltd. (known as 'transferor company') shall prepare a draft scheme under which the assets and liabilities of Moonlit Consultants Ltd. as comprised in the plantation and tourism business shall be transferred to the associate company (known as 'transferee company'). The scheme shall specify the necessary details like-

(a) agreed values for transfer of assets and liabilities;
(b) the consideration for the transfer;
(c) where the associate company issues shares to the shareholders of M/s Moonlit Consultants Ltd., the exchange ratio of the shares;
(d) other terms and conditions.

2. An application shall be made to the Court by Moonlit Consultants Ltd. jointly with the Associate company.
3. The Court may order that a meeting of the creditors or members or any class of them be called, held and conducted in the manner directed by the Court.
4. The Court shall give notice of every application seeking a compromise or arrangement to the Central Government. The Central Government is empowered to make a representation and the Court shall take into account such representation while passing any order in respect of the scheme of compromise or arrangement (Section 394A).
5. Where a meeting of creditors or members is called, the notice given to them must contain-

(a) the terms of the compromise or arrangement;
(b) an explanatory statement explaining the effect of compromise or arrangement;
(c) a statement explaining any material interests of the directors, managing director, or manager of the company. The effect of those interests on the scheme should be explained stating if and how they are different from the like interests of other persons.

6. The meeting shall be held and conducted in the manner as directed by the Court. The scheme must be approved by more than 50% of the members who hold at least 75% of the value of shares.
7. The Court has the discretion to sanction the scheme placed before it. Where the Court is Satisfied that the scheme is bona fide, it may sanction the scheme.
8. The scheme becomes effective only after a certified copy of the order is filed with the registrar. Until such filing the sanctioned scheme remains dormant and no creditor or member can enforce any right under the scheme.
9. After the certified copy of the scheme is filed with the registrar, the company shall annex to every copy of memorar.dum, a copy of such scheme.

10. Necessary Steps shall be taken to give effect to the scheme as approved by the Court.

(b) The memorandum of association explains the scope of operations of a company beyond which the company cannot go. Anything done by a company outside the objects clause of memorandum is ultra vires the company.

However, to amalgamate with another company is a power of the company, and not an object of the company. Therefore, no power to amalgamate is required in the memorandum of a company before making an application to the Court for effecting amalgamation. Also, the power to amalgamate has been given by the statute under section 394 of Companies Act, 1956. Since there is a statutory provision dealing with amalgamation of companies (which does not require that such a provision must be present in the memorandum or articles of the company), no special power in the objects clause of the memorandum is necessary for its amalgamation with another company. Section 394 is a complete code which gives full jurisdiction to the Court to sanction amalgamation of companies, even though there may be no power in the objects clause of memorandum [Re, EITA India Ltd., AIR 1997 Cal 208; United Bank of India v United India Credit d Development Co. Ltd. (1977) 47 Comp Cos 689, 730 (Cal)].

<u>Question 16:</u>

(a) Strong Company Limited was merged with Feeble Company Limited on account of amalgamation. Some workers of Strong Company Limited refused to join as workers of Feeble Company Limited and claimed compensation on the ground of premature termination of their services. Feeble Company Limited resists the claim of the workers on the ground that their services have been transferred to Feeble Company Limited in view of the order of amalgamation and merger and hence the workers must join the service of Feeble Company Limited and cannot claim any compensation.

State the powers of the court about the matters that would be considered while sanctioning the scheme of amalgamation under the provisions of the Companies Act, 1956. Decide whether the contention of the workers is justified.

(b) The members of both Sugam Synthetix Limited and Gaurav Textiles Limited approved the scheme of amalgamation by overwhelming majority. A reputed firm of Chartered Accountants fixed the exchange ratio. The scheme of amalgamation was submitted, as per procedure, for the sanction of the Court. During pendency of the matter a small group of members of one of the merging companies objected to the amalgamation on the ground that the exchange ratio was unfair.

Decide whether the said objection is likely to be sustained. Would your answer be different if similar objection was raised by the Central Government?

(c) Sudam Ltd. has gone into liquidation because of the inability of the company to pay its debts. During the course of winding up, a proposal was put forward by the previous management to revive the working of the company through a scheme of arrangement between the company and its creditors. As per the scheme, all the creditors have to forego fifty percent of

their dues. Some of the creditors have voiced their opposition to the said scheme. The company approaches you for advice. State the steps that have to be taken by the company in this regard.

For part (a), (b) and (c) of the above question, provisions relating to Companies Act, 1956 is considered while answering since corresponding sections of Companies Act, 2013 are still not enforced.

<u>Answer:</u>

(a) As per section 394, the order of the Court sanctioning the reconstruction or amalgamation shall be sufficient to vest all the properties or liabilities in the transferee company without execution of any further document. However, the order shall not automatically transfer contracts of personal service, e.g., the services of workers cannot be transferred to the transferee company without their consent; no contract of service is created between the workers and the transferee company [Nokes v Doncaster Amalgamated Collieries Ltd. (1940) 3 All ER 549]. Therefore in the given case, workers of Strong Company Limited will succeed against Feeble Company Limited. The workers cannot be compelled to join Feeble Company Limited, and therefore, they shall be entitled to receive compensation.

(b) On an application made to the Court for sanctioning a scheme of amalgamation or reconstruction, the Court may make an order sanctioning it. Once statutory formalities are complied with, the onus lies on those opposing the scheme to satisfy the Court that the scheme is unfair or unreasonable or fraudulent [Re, Hindustan General Electric Corporation Ltd. (1959) 29 Comp Cos 46; Re, Sussex Brick Co. Ltd. (1960) 30 Comp Cas 536].

Where, the valuation is confirmed to be fair by eminent firm of Chartered Accountants and is also approved by overwhelming majority, the Court will not find fault with the exchange ratio (Re, Tata Oil Mills Co. Ltd., Re, Hindustan Lever Ltd.).

Where the exchange ratio was fixed by two reputed firms of chartered accountants who had examined the accounts, annual reports, working results and financial positions of the two companies and certified on that basis that the share exchange ratio of 5:2 was fair and reasonable, and the scheme was widely advertised, unanimously approved and no objection was raised by any of the affected quarters, and the Central Government had not affirmatively established that the valuation of assets was unfair or inequitable, the Court refused to interfere (M. G. Investment & Industrial Co. Ltd. v New Shorrock Spg. d Mfg. Co. Ltd.).
Thus, if, on overall consideration the Court is satisfied as to feasibility of the Scheme, it should not hesitate to grant sanction [Re, Ucal Fuel Systems Ltd.].

Applying the above Court rulings, the given problems are answered as under:

(i) The dissenting shareholders shall not succeed unless they satisfy the Court that the valuation is grossly unfair (Re, Piramal Spg. & Wvg. Mills Ltd.)

(ii) Even if exchange ratio is objected by the Central Government, the Court may sanction the scheme, since the representation or opinion made by the Central Government to the Court under section 394A is not binding on the Court.

(c) Section 517 provides the opportunity to a company to enter into an arrangement with its creditors even though it is about to be, or is in the course of being, wound up. However, a company can claim the benefit of section 517 only in case of voluntarily winding up (whether members' voluntary winding up or creditors' voluntary winding up).

1. Requirements of section 517

The provisions of section 517 are explained as under:

(a) The scheme of arrangement must be sanctioned by a special resolution of the company.

(b) The scheme must also be agreed to by three-fourths in number and value of the creditors.

(c) Any creditor or contributory may, within 3 weeks from the completion of the arrangement, appeal to the Court against the scheme of arrangement.

(d) On an appeal made to the Court, the Court shall have the power to amend, vary, confirm or set aside the arrangement.

2. Procedure under section 517

A company may enter into a scheme of arrangement with the creditors by following the procedure as given hereunder:

(a) The draft scheme of arrangement shall be considered and approved by the Board of directors.

(b) The company shall apply to the Court for directions to convene the meetings of the members and creditors.

(c) A general meeting of the company shall be held and the special resolution approving the scheme of arrangement shall be passed.

(d) A meeting of creditors shall be held whereat the scheme shall be agreed to by three-fourths in number and value of the creditors.

(e) The company shall approach the Court for approval of the scheme.

(f) On receipt of the Court's order, the company shall file a certified copy of the Court's order with the registrar.

<u>STUDY NOTE 3 – SEBI LAWS AND REGULATIONS:</u>

<u>Question 17:</u>

(a) An investor has complained to SEBI that he has not received the payment due to him from the stock broker registered with Calcutta Stock Exchange Association Ltd. The complainant has requested SEBI to take appropriate action against the stock broker. You are required to state with reference to the provisions of SEBI Act, 1992 the answer to the following:

(i) What action SEBI can take against the stock broker on the complaint as stated above?

(ii) What is the procedure to be adopted and what are the factors that will be taken into account while taking such action?

(b) Referring to the provisions of SEBI Act, 1992, discuss the meaning and functions of the board.

Answer:

(a) The provisions are discussed as under:

1. Penalty for non-payment by a stock broker

A registered stock broker is liable to penalty under section 15F in respect of certain defaults. Accordingly, if a stock broker fails to make payment of the amount due to the investor in the manner and within the period specified in the regulations, he shall be liable to a penalty of ₹1,00,000 for each day during which such failure continues of ₹1 crore, whichever is less.

2. Procedure for adjudication

As per section 15 I, SEBI shall appoint any of its officers (not below the rank of Division Chief) to be an adjudicating officer for holding an enquiry in the prescribed manner. The adjudicating officer shall give an opportunity of being heard before imposing any penalty.

3. Factors to be taken into consideration while imposing penalty

As per section 15J, while adjudging the quantum of penalty, the adjudicating officer shall have due regard to the following factors:

(a) The amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default.
(b) The amount of loss caused to an investor or group of investors as a result of the default
(c) The repetitive nature of the default.

(b) As per section 2(1)(a) of SEBI Act, 1992, "Board" means the Securities and Exchange Board of India established under section 3;

As per section 3:

(1) With effect from such date as the Central Government may, by notification, appoint, there shall be established, for the purposes of this Act, a Board by the name of the Securities and Exchange Board of India.
(2) The Board shall be a body corporate by the name aforesaid, having perpetual succession and a common seal, with power subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract, and shall, by the said name, sue or be sued.
(3) The head office of the Board shall be at Bombay.
(4) The Board may establish offices at other places in India

The functions of the board as per section 11 of SEBI Act, 1992 are as follows:

(1) Subject to the provisions of this Act, it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit.

(2) Without prejudice to the generality of the foregoing provisions, the measures referred to therein may provide for-

(a) regulating the business in stock exchange and any other securities markets;

(b) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;

(c) registering and regulating the working of collective investment schemes, including mutual funds;

(d) promoting and regulating self-regulatory organizations;

(e) prohibiting fraudulent and unfair trade practices relating to securities markets;

(f) promoting investors' education and training of intermediaries of securities markets;

(g) prohibiting insider trading in securities;

(h) regulating substantial acquisition of shares and take-over of companies;

(i) calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchange and intermediaries and self-regulatory organizations in the securities market;

(j) performing such functions and exercising such powers under the provision of the Capital Issues (Control) Act, 1947 (29 of 1947) and the Securities Contracts (Regulation) Act, 1956, (42 of 1956) as may be delegated to it by the Central Government;

(k) levying fees or other charges for carrying out the purposes of this section;

(l) conducting research for the above purposes;

(m) performing such other function as may be prescribed

STUDY NOTE 4 – THE COMPETITION ACT AND ITS ROLE IN CORPORATE GOVERNANCE:

Question 18:

(a) Explain the powers of the Commission to approve modify or disapprove a combination as per The Competition Act, 2002.

(b) An arrangement has been made among the Silk Producers that the Silk produced by them will not be sold to mills below a Certain Price. The arrangement is in writing but it not intended to be enforced by legal proceedings. Examine whether the said arrangement can be considered as an arrangement within the meaning of Sec. 2 (b) of the Competition Act, 2002.

Answer:

(a) The Powers of the Commission to approve, modify or disapprove a combination are explained below:

1. Where combination does not have any adverse effect on competition:

Where the Commission is of the opinion that any combination does not, or is not likely to, have an appreciable adverse effect on competition, it shall, by order, approve that combination including the combination in respect of which a notice has been given under section 6(2).

2. Combination not to take effect if it has any adverse effect on competition:

Where the Commission is of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition, it shall direct that the combination shall not take effect.

3. Modification of combination to eliminate the adverse effect:

(i) When can Commission propose modification?

Where the Commission is of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition but such adverse effect can be eliminated by suitable modification to such combination; it may propose appropriate modification to the combination, to the parties to such combination.

(ii) Acceptance of modification

The parties, who accept the modification proposed by the Commission, shall carry out such modification within the period specified by the Commission.

(iii) Failure to carry out accepted modification -Consequences

If the parties to the combination, who have accepted the modification, fail to carry out the modification within the period specified by the Commission, such combination shall be deemed to have an appreciable adverse effect on competition and the Commission shall deal with such combination in accordance with the provisions of this Act.

(iv) Refusal of parties to accept modification

- The parties to the combination may not accept the modification proposed by the Commission.
- In such a case, the parties may, within next 30 working days, submit amendment to the modification proposed by the Commission.
- However, if the parties do not accept the modification proposed by the Commission within 30 days, and also do not submit amendment to the modification proposed by the Commission, the combination shall be deemed to have an appreciable adverse effect on competition.

(v) Commission may agree to the amendments

If the Commission agrees with the amendment submitted by the parties, it shall, by order, approve the combination.

(vi) Refusal of Commission to agree to amendments

- If the Commission does not accept the amendment submitted by the parties, then, the parties shall be allowed a further period of 30 working days within which such parties shall accept the modification proposed by the Commission.
- If the parties fail to accept the modification proposed by the Commission within next 30 working days, the combination shall be deemed to have an appreciable adverse effect on competition.

4. Consequences where the Commission declares that combination has adverse effect on competition

Where the Commission has directed that the combination is deemed to have an appreciable adverse effect on competition, then, without prejudice to any penalty which may be imposed or any prosecution which may be initiated under this Act, the Commission may order that the combination shall not be given effect to.

(b) As per Sec. 3(4), Vertical Agreements are amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage sale or price of, or trade in goods (or) provision of services. They include the following arrangements / agreements –

1. Tie-in Arrangement:

Includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods.

2. Exclusive Supply Agreement:

Includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the Seller or any other person.

3. Exclusive Distribution Agreement:

Includes any agreement to limit, restrict or withhold the output or supply of any goods, or allocate any area or market for the disposal or sale of goods.

4. Refusal to Deal:

Includes any agreement which restricts, or is likely to restrict, by any method, the persons or classes of persons to whom goods are sold or from whom goods are bought.

5. Resale Price Maintenance:

Includes any agreement to sell goods on condition that the prices to be charged on the resale by the Purchaser shall be the prices stipulate by the Seller, unless it is clearly stated that prices lower than those prices may be charged.

Such Vertical Agreements shall be considered anti-competitive (and hence void), if it causes or is likely to cause an appreciable adverse effect on competition in India.

Note:

Horizontal Agreements are presumed anti-competitive u/s 3(3) and hence void. However, Vertical Agreements are anti-competitive and void u/s 3(4) only when they cause appreciable adverse effect on competition in India.

In the given case, agreement stipulates the Resale Price and does not allow the Purchaser to sell the goods at prices lower than the stipulated prices, hence invalid. It is a Vertical Anti-Competitive Agreement.

STUDY NOTE 5 – LAWS RELATED TO BANKING SECTOR:

Question 19:

(a) Mr. Gabbar is a director in a Bank. The Reserve Bank of India terminates him on the ground that his conduct is detrimental to the interest of the depositors. Decide whether the Reserve Bank of India can do so under the Banking Regulation Act, 1949. Can the Reserve Bank of India appoint Additional Director in a Bank under the said Act?

(b) The Banking Companies, Financial Institutions and Intermediaries of securities market are under some obligations under the Prevention of Money Laundering Act, 2002. State in brief, these obligations.

(c) Zodiac Bank Limited is not managing its affairs properly. Employees as well as depositors of the bank have complained to the Central Government from time to time about such mismanagement and requested the Central Government to acquire the undertaking of the Banking Company. Explain the powers of the Central Government in this regard under the Banking Regulation Act, 1949.

(d) Printed Computer is a Singapore based company having several business units all over the world. It has a unit for manufacturing computer printers with its headquarters in Pune. It has a branch in Dubai which is controlled by the headquarters in Pune. What would be the residential status under FEMA, 1999 of printer units in Pune and that of Dubai branch?

(e) Ranvir Ltd. is a securitization and reconstruction company under SARFAESI Act, 2002. The certificate of registration granted to it was cancelled. State the authority which can cancel the registration and the right of Ranvir Ltd. against such cancellation.

Answer:

(a) The Reserve Bank is empowered to remove the managerial and other persons as per the provisions of section 36AA, which is explained below:

1. Conditions for removal of managerial and other persons (Section 36AA(1)]

Where the Reserve Bank is satisfied that in the public interest or for preventing the affairs of a banking company being conducted in a manner detrimental to the interests of the depositors or for securing the proper management of any banking company it is necessary so to do, the Reserve Bank may, for reasons to be recorded in writing, by order, remove from office, with effect from such date as may be specified in the order, any chairman, director, chief executive officer (by whatever name called) or other officer or employee of the banking company

2. Issue of show cause notice before removal [Section 36AA(2)]

No order under sub-section (1) shall be made unless the chairman, director or chief executive officer or other officer or employee concerned has been given a reasonable opportunity of making a representation to the Reserve Bank against the proposed order.

Note: Overriding effect of Section 36AA (Section 36AC)

Any removal of a director, chief executive officer or other officer or employee in pursuance of section 36AA shall have effect notwithstanding anything to the contrary contained in the Companies Act, 1956 or any other law for the time being in force or in any contract or any other instrument.

(b) The obligations of Banking Companies, Financial Institutions and Intermediaries with respect to maintenance of accounts is explained below:

1. <u>Duties of Banking companies, Financial Institutions and Intermediaries [Section 12(1)]:</u>

Every banking company or financial institution and intermediary shall -

(i) maintain a record of all transactions, the nature and value of which may be prescribed, whether such transactions comprise of a single transaction or a series of transactions integrally connected to each other, and where such series of transactions take place within 1 month;

(ii) furnish information of transactions referred to in clause (a) to the Director within such time as may be prescribed;

(iii) verify and maintain the records of the identity of all its clients, in such a manner as may be prescribed.

2. <u>Furnishing of information where transaction(s) below the prescribed value are suspicious [Proviso to Section 12(1)]:</u>

Where the principal officer of a banking company or financial institution or intermediary, as the case may be, has reason to believe that a single transaction or series of transactions integrally connected to each other have been valued below the prescribed value so as to defeat the provisions of this section, such officer shall furnish information in respect of such transactions to the Director within the prescribed time.

3. <u>Period of maintenance of records [Section 12(2)]</u>

(i) The records referred to in clause (a) of sub-section (1) shall be maintained for a period of 10 years from the date of transactions between the clients and the banking company or financial institution or intermediary, as the case may be.

(ii) The records referred to in clause (c) of sub-section (1) shall be maintained for a period of 10 years from the date of cessation of transactions between the clients and the banking company or financial institution or intermediary, as the case may be.

The Central Government may, in consultation with the Reserve Bank of India, prescribe the procedure and the manner of maintaining and furnishing information under sub-section (1) of section 12 for the purpose of implementing the provisions of this Act (Section 15).

(c) Section 36AE empowers the Reserve Bank to acquire the undertakings of banking companies, as explained below:

A. <u>Conditions for acquisition of any undertaking of a banking company [Section 36AE(1)]</u>

If, upon receipt of a report from the Reserve Bank, the Central Government is satisfied that a banking company -

1. has, on more than one occasion, failed to comply with the directions given to it, in so far as such directions relate to banking policy, or
2. is being managed in a manner detrimental to the interests of its depositors, and that –
   (i) in the interests of the depositors of such banking company, or
   (ii) in the interest of banking policy, or
   (iii) for the better provision of credit generally or of credit to any particular section of the community or in any particular area, it is necessary to acquire the undertaking of such banking company, the Central Government may, after such consultation with the Reserve Bank as it thinks fit, by notified order, acquire the undertaking of such company (hereinafter referred to as the acquired bank) with effect from such date as may be specified in this behalf by the Central Government (hereinafter referred to as the appointed day).

B. <u>No acquisition unless opportunity to show cause given [Proviso to Section 36AE(1)]</u>

No undertaking of any banking company shall be acquired unless such banking company given a reasonable opportunity of showing cause against the proposed action.

C. <u>Vesting of undertaking in the Central Government from the appointed day [Section 36AE(2)]</u>

Subject to the other provisions contained in this Part, on the appointed day, the undertaking of the acquired bank and all the assets and liabilities of the acquired bank shall stand transferred to, and vest in, the Central Government.

D. <u>Continuation of suits and other proceedings [Section 36AE(7)]</u>

If, on the appointed day, any suit, appeal or other proceeding of whatever nature is pending by or against the acquired bank, the same shall not abate, be discontinued or be, in any way, prejudicially affected by reason of the transfer of the undertaking of the acquired bank or of anything contained in this Part, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the Central Government.

(d) Section 2(u) defines a 'person'. As per this definition, the following shall be covered in the definition of a 'person':

(i) A company.
(ii) Any agency, office or branch owned by a 'person'.

Section 2(v) defines a 'person resident in India'. As per this definition, the following shall be covered in the definition of a 'person resident in India':

(i) An office, branch or agency in India owned or controlled by a person resident outside India.
(ii) An office, branch or agency outside India owned or controlled by a person resident in India.

In the given case, Printed Computers (Singapore), its headquarters in Pune as well as Dubai Branch is a 'person'. Therefore, residential status under FEMA shall be determined for each of them separately.

(i) Printed Computers (Singapore) does not fall under any of the clauses of the definition of a 'person resident in India'. Therefore, Printed Computers (Singapore) is a person resident outside India.

(ii) The Pune Headquarters of Printed Computers is a 'person resident in India' since it falls under the clause 'an office, branch or agency in India owned or controlled by a person resident outside India'.
(iii) The Dubai branch of Printed Computers (Singapore), though not owned, is controlled by the Pune headquarters. The Dubai branch is a 'person resident in India' since it falls under the clause 'an office, branch or agency outside India owned or controlled by a person resident in India'.

(e) The provisions relating to cancellation of certificate of registration of a securitisation or reconstruction company are explained below:

1. Circumstances in which certificate may be cancelled [Section 4(1)]

The Reserve Bank may cancel a certificate of registration granted to a securitisation company or a reconstruction company, if such company:

(i) ceases to carry on the business of securitisation or asset reconstruction; or
(ii) ceases to receive or hold any investment from a qualified institutional buyer; or
(iii) has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or
(iv) at any time fails to fulfill any of the conditions referred to in clauses (a) to (g) of sub-section (3) of section 3; or
(v) fails to:
- comply with any direction issued by the Reserve Bank under the provisions of this Act; or
- maintain accounts in accordance with the requirements of any law or any direction or order issued by the Reserve Bank under the provisions of this Act; or
- submit or offer for inspection its books of account or other relevant documents when so demanded by the Reserve Bank; or
- obtain prior approval of the Reserve Bank required under sub-section (6) of section 3.

Opportunity of being heard before cancellation in certain cases [Proviso to Section 4(1)].

Provided that before cancelling a certificate of registration on the ground that the securitisation company or reconstruction company has failed to comply with the provisions of clause (c) or has failed to fulfill any of the conditions referred to in clause (d) or sub-clause (iv) of clause (e), the Reserve Bank, unless it is of the opinion that the delay in cancelling the certificate of registration granted under sub-section (4) of section 3 shall be prejudicial to the public interest or the interest of the investors or the securitisation company or the reconstruction company, shall give an opportunity to such company on such terms as the Reserve Bank may specify for taking necessary steps to comply with such provisions or fulfillment of such conditions.

2. Appeal against order of cancellation [Section 4(2)]

A securitisation company or reconstruction company aggrieved by the order of cancellation of certificate of registration may prefer an appeal, within a period of 30 days from the date on which such order of cancellation is communicated to it, to the Central Government.

Opportunity of being heard before rejection of appeal [Proviso to Section 4(2)].

Before rejecting an appeal such company shall be given a reasonable opportunity of being heard.

3. Consequences of rejection or cancellation of certificate of registration where the company is already holding investments [Section 4(3)]

A securitisation company or reconstruction company, which is holding investments of qualified institutional buyers and whose application for grant of certificate of registration has been rejected or certificate of registration has been cancelled shall, notwithstanding such rejection or cancellation, be deemed to be a securitisation company or reconstruction company until it repays the entire investments held by it (together with interest, if any) within such period as the Reserve Bank may direct

STUDY NOTE 6 – LAWS RELATING TO INSURANCE SECTOR:

Question 20:

(a) Explain briefly the powers of the Central Government to issue directions to the Authority under The Insurance Regulatory & Development Authority Act, 1999

(b) Is the Central Government empowered to supersede the Authority under Insurance Regulatory & Development Authority Act, 1999? Explain.

Answer:

(a) The provisions of section 18 may be explained as follows:

(i) Nature of directions and their binding effect [Section 18(1)]

Without prejudice to the foregoing provisions of this Act, the Authority shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy, other than those relating to technical and administrative matters, as the Central Government may give in writing to it from time to time:

Opportunity to Authority before giving directions [Proviso to Section 18(1)].

The Authority shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section.

(ii) 'Question of policy or not' to be decided by the Central Government [Section 18(2)]

The decision of the Central Government, whether a question is one of policy or not, shall be final.

(b) Section 19 empowers the Central Government to supersede the Authority. These provisions may be explained as follows:

1. Reasons for supersession [Section 19(1)]:

The Central Government may supersede the Authority if it is of the opinion:

(i) that, on account of circumstances beyond the control of the Authority, it is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act; or

(ii) that the Authority has persistently defaulted in complying with any direction given by the Central Government under this Act or in the discharge of the functions or performance of the duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of the Authority or the administration of the Authority has suffered; or
(iii) that circumstances exist which render it necessary in the public interest to supersede the Authority.

2. Conditions for making an order of supersession [Section 19(1) and Proviso to Section 19(1)]

(i) The Central Government shall be required to issue a notification stating therein the reasons for supersession and the period of supersession, which shall not exceed 6 months.
(ii) Before issuing any such notification, the Central Government shall give a reasonable opportunity to the Authority to make representations against the proposed supersession and shall consider the representations, if any, of the Authority.
(iii) The Central Government shall appoint a person to be the Controller of Insurance under section 2B of the Insurance Act, 1938, if not already done.

3. Effects of supersession [Section 19(2)]

Upon the publication of notification under sub-section (1) superseding the Authority, -

(i) the Chairperson and other members shall, as from the date of supersession, vacate their offices as such;
(ii) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Authority shall, until the Authority is reconstituted under sub - section (3), be exercised and discharged by the controller of Insurance; and
(iii) all properties owned or controlled by the Authority shall, until the Authority is reconstituted under sub-section (3), vest in the Central Government.

4. Reconstitution of Authority [Section 19(3)]

On or before the expiration of the period of supersession specified in the notification issued under sub section (1), the Central Government shall reconstitute the Authority by a fresh appointment of its Chairperson and other members and in such case any person who had vacated his office under clause (a) of sub-section (2) shall not be deemed to be disqualified for reappointment.

5. Laying of documents before the Parliament [Section 19(4)]

The Central Government shall cause a copy of the notification issued under sub-section (1) and a full report of any action taken under this section and the circumstances leading to such action to be laid before each House of Parliament at the earliest.

Question 21:

(a) What are the provisions in the Insurance Act, 1938 regarding nomination by a Life Insurance Policy Holder? Whether a minor can be a nominee in a Life Insurance Policy

(b) Write short note on management by administrator under The Insurance Act, 1938.

Answer:

(a) The provisions regarding nomination by a Life Insurance Policy Holder are as under:

1. Nomination:

The holder of a policy of life insurance on his own life, may, when effecting the policy or at any time before the policy matures for payment, nominate the person or persons to whom the money secured by the policy shall be paid in the event of his death.

2. Endorsement on the policy:

Any such nomination in order to be effectual shall, unless it is incorporated in the text of the policy itself, be made by an endorsement on the policy communicated to the insurer and registered by him in the records relating to the policy and any such nomination may at any time before the policy matures for payment be cancelled or changed by an endorsement or a further endorsement or a will, as the case may be, but unless notice in writing of any such cancellation or change has been delivered to the insurer, the insurer shall not be liable for any payment under the policy made bona fide by him to a nominee mentioned in the text of the policy or registered in records of the insurer.

3. Acknowledgement:

The Insurer shall furnish to the Policy-Holder a written acknowledgement of having registered a nomination or a cancellation or change thereof, and may charge a fee not exceeding ₹1 for registering such cancellation or change.

4. Assignment u/s 38:

A transfer or assignment of a policy made in accordance with section 38 shall automatically cancel a nomination. The assignment, of a policy to the Insurer who bears the risk on the policy at the time of the assignment, in consideration of a loan granted by that insurer on the security of the Policy within its surrender value, or its reassignment on repayment of the loan shall not cancel a nomination, but shall affect the rights of the nominee only to the extent of the insurer's interest in the policy

5. Minor Nominee:

Where any nominee is a minor, it shall be lawful for the Policy Holder to appoint in the prescribed manner any person to receive the money secured by the policy in the event of his death during the minority of the nominee. Hence, a Minor can be a nominee in a Life Insurance policy.

(b) When Administrator for management of insurance business may be appointed [Section 52A]:

1. If at any time the Authority has reason to believe that an insurer carrying on life insurance business is acting in a manner likely to be prejudicial to the interests of holders of life insurance policies, he may, after giving such opportunity to the insurer to be heard as he thinks fit, make a report thereon to the Central Government.

2. The Central Government, if it is of opinion after considering the report that it is necessary or proper to do so, may appoint an Administrator to manage the affairs of the insurer under the direction and control of the Authority.

3. The Administrator shall receive such remuneration as the Central Government may direct and the Central Government may at any time cancel the appointment and appoint some other person as Administrator.

4. The management of the business of the insurer shall as on and after the date of appointment of the Administrator vest in such Administrator, but except with the leave of the Authority the Administrator shall not issue any further policies.

5. As on and after the date of appointment of the Administrator any person vested with any such management immediately prior to that date shall be divested of that management.

6. The Authority may issue such directions to the Administrator as to his powers and duties as he deems desirable in the circumstances of the case, and the Administrator may apply to the Authority at any time for instructions as to the manner in which he shall conduct the management of the business of the insurer or in relation to any matter arising in the course of such management.

<u>Powers and duties of the Administrator [Section 52B]:</u>

1. The Administrator shall conduct the management of the business of the insurer with the greatest economy compatible with efficiency and shall, as soon as may be possible, file with the Authority a report stating which of the following courses is in the circumstances most advantageous to the general interests of the holders of life insurance policies, namely:
(i) the transfer of the business of the insurer to some other insurer:
(ii) the carrying on of its business by the insurer (whether with the policies of the business continued for the original sum insured with the addition of bonuses that attach to the policies or for reduced amounts);
(iii) the winding up of the insurer; and
(iv) Such other course as he deems advisable.

2. On the filing of the report with the Authority, the Authority may take such action as he thinks fit for promoting the interests of the holders of life insurance policies in general.

3. Any order passed by the Authority under sub-section (2), shall be binding on all persons concerned, and shall have effect notwithstanding anything in the memorandum or articles of association of the insurer, or a company.

<u>STUDY NOTE 7 – LAWS RELATING TO POWER SECTOR:</u>

<u>Question 22:</u>

(b) Discuss the circumstances under which the Appropriate Government may revoke the license under The Electricity Act, 2003.

(c) What are the qualifications to be appointed as members of Central Commission as per 'The Indian Electricity Act, 2003'?

<u>Answer:</u>

(a) The circumstances under which the Appropriate Government may revoke the license under 'The Indian Electricity Act, 2003 has been stated under section 19 of the Act as follows:

1. If the Appropriate Commission, after making an enquiry, is satisfied that public interest so requires, it may revoke a license in any of the following cases, namely:

(a) where the licensee, in the opinion of the Appropriate Commission, makes willful and prolonged default in doing anything required of him by or under this Act or the rules or regulations made there under;
(b) where the licensee breaks any of the terms or conditions of his license the breach of which is expressly declared by such license to render it liable to revocation;
(c) where the licensee fails, within the period fixed in this behalf by his license, or any longer period which the Appropriate Commission may have granted therefore:
   (i) to show, to the satisfaction of the Appropriate Commission, that he is in a position fully and efficiently to discharge the duties and obligations imposed on him by his license; or and obligations imposed on him by his license; or
   (ii) to make the deposit or furnish the security, or pay the fees or other charges required by his license;
(d) Where in the opinion of the Appropriate Commission the financial position of the licensee is such that he is unable fully and efficiently to discharge the duties and obligations imposed on him by his license.

Where in its opinion the public interest so requires, the Appropriate Commission may, on application, or with the consent of the licensee, revoke his license as to the whole or any part of his area of distribution or transmission or trading upon such terms and conditions as it thinks fit.

No license shall be revoked under sub-section (1) unless the Appropriate Commission has given to the licensee not less than 3 months' notice, in writing, stating the grounds on which it is proposed to revoke the license, and has considered any cause shown by the licensee within the period of that notice, against the proposed revocation.

The Appropriate Commission may, instead of revoking a license under sub-section (1), permit it to remain in force subject to such further terms and conditions as it thinks fit to impose, and any further terms or conditions so imposed shall be binding upon and be observed by the licensee and shall be of like force and effect as if they were contained in the license.

Where the Commission revokes a license under this section, it shall serve a notice of revocation upon the licensee and fix a date on which the revocation shall take effect.

Where an Appropriate Commission has given notice for revocation of license under sub-section (5), without prejudice to any penalty which may be imposed or prosecution proceedings which may be initiated under this Act, the licensee may, after prior approval of that Commission, sell his utility to any person who is found eligible by that Commission for grant of license.

(b) Qualification for appointment of Members of Central Commission [Section 77]:

1. The Chairperson and the Members of the Central Commission shall be persons having adequate knowledge of, or experience in, or shown capacity in, dealing with, problems relating to engineering, law, economics, commerce, finance or, management and shall be appointed in the following manner, namely:

(i) one person having qualifications and experience in the field of engineering with specialisation in generation, transmission or distribution of electricity;
(ii) one person having qualifications and experience in the field of finance;
(iii) two persons having qualifications and experience in the field of economics, commerce, law or management:

2. Notwithstanding anything contained in sub-section (1), the Central Government may appoint any person as the Chairperson from amongst persons who is, or has been, a Judge of the Supreme Court or the Chief Justice of a High Court:

Provided that no appointment under this sub-section shall be made except after consultation with the Chief Justice of India.

3. The Chairperson or any other Member of the Central Commission shall not hold any other office.

4. The Chairperson shall be the Chief Executive of the Central Commission.

STUDY NOTE 8 – CORPORATE GOVERNANCE:

Question 23:

(a) Explain the term "Corporate Governance", in details.

(b) Discuss about the importance and functions of the 'supervisory board' as per the Cromme code of Germany.

Answer:

There is no single, accepted definition of Corporate Governance. There are substantial differences in definition according to which country we are considering. Corporate Governance as a discipline in its own right is relatively new. We consider that the subject may be treated in a narrow or a broad manner, depending on the viewpoint of the policy maker, practitioner, researcher or theorist. It seems that existing definitions of Corporate Governance fall on to a spectrum, with 'narrow' views at one end and more inclusive, 'broad' views placed at the other.

Once approach toward Corporate Governance adopts a narrow view, where Corporate Governance is restricted to the relationship between a company and its shareholders. This is the traditional finance paradigm, expressed in 'agency theory'. At the other end of the spectrum, corporate governance may be seen as a web of relationships, not only between a company and its owners (shareholders) but also between a company and a broad range of other 'stakeholders': employees, customers, supplies, bondholders, to name but a few. Such a view tends to be expressed in 'stakeholder theory'. This is a more inclusive and broad way of treating the subject of corporate governance and one which is gradually attracting greater attention.

Corporate governance is…

- The process of supervision and control intended to ensure that the company's management acts in accordance with the interests of shareholders (Parkinson, 1994). – Strongly agree

- The governance role is not concerned with the running of the business of the company per se, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries (Tricker, 1984). – Agree

- The governance of an enterprise is the sum of those activities that make up the internal regulation of the business in compliance with the obligations placed on the firm by legislation, ownership trusteeship of assets, their management and their deployment (cannon, 1994). – Agree

- The relationship between shareholders and their companies and the way in which shareholders act to encourage best practice (e.g., by voting at AMs and by regular meetings with companies' senior management). Increasingly, this includes shareholder 'activism' which involves a campaign by a shareholder or a group of shareholders to achieve change in companies (the Corporate Governance Handbook, 1996). – Some agreement

- The structures, process, cultures and systems that engender the successful operation of the Organization (Keasey and Wright, 1993). – Some agreement

- The system by which companies are directed and controlled (The Cadbury Report, 1992) – slight agreement

Theoretical frameworks that suggest companies should be accountable only to their shareholders are not necessarily inconsistent with theoretical frameworks that champion stakeholder accountability. The reason underlying this argument is that shareholders' interest can only be satisfied by taking account of stakeholder interests, as companies that are accountable to all of their stakeholders are over the long term more successful and more prosperous. Definition of Corporate Governance therefore rests on the perception that companies can maximize value creation over the long term, by discharging their accountability to all of their stakeholders and by optimizing their system of Corporate Governance.

Overall, this perception is growing among the professional community and academic research is beginning to provide empirical in support of this view of corporate governance, accountability and corporate profitability. However, this is the 'business case' for corporate governance and, more generally, for corporate social responsibility. Should companies improve corporate governance and discharge accountability to all of their stakeholders purely because it is ethical? We discuss these ethical issues in the subsection on stakeholder theory. In the real world, it is unlikely that businessmen and investors will be interested in acting ethically unless there are positive financial returns to be made from so doing, as there appears to be a strong business case underlying corporate governance reform and stakeholder accountability, then the corporate and financial communities are more likely to embrace these approaches.

(b) The committee on corporate governance in Germany was chaired by Dr. Gerhard Cromme and is usually referred to as the Cromme Report or Cromme Code. The code harmonizes a wide variety of laws and regulations and contains recommendations and also suggestions for complying with international best practice on Corporate Governance.

The Cromme Code was published in 2002 and is split into a number of sections, starting with a section on shareholders and the general meeting. The Cromme Code also reflects some of the latest developments in technology. The Cromme Code was amended in 2005.

Supervisory board:

It is important that the composition of the supervisory board reflects a suitable level of knowledge, ability, and experience to be able properly to carry out the tasks relevant to the business. There should be an adequate number of independent members.

'Independence' will mean no business or personal relations with the company or its management board which cause a conflict of interest. To help maintain its independence, not more than two former members of the management board should be members of the supervisory board. The former management board chairman or a management board member should not generally become supervisory board chairman or chairman of a supervisory board committee. Supervisory board members should · not have director ships or similar positions or indeed have advisory roles with important competitors of the enterprise.

The supervisory board carries out a number of important functions as follows:

1. It provides independent advice and supervision regularly to the management board on the management of the business;
2. The management board and the supervisory board should ensure that there is a long-term succession plan in place;
3. The supervisory board may delegate some duties to other committees, which include compensation and audit committees;
4. The chairman of the supervisory board, who should not be the chairman of the audit committee, co-ordinates work within the supervisory board and chairs its meetings and attends to the affairs of the supervisory board externally.

It is worth elaborating on the committees that may be formed with a remit for various delegated areas. These may include the audit committee (the chairman of the audit committee should not be a former member of the management board of the company); the chairman of the audit committee should have specialist knowledge and experience in the application of accounting principles and internal control processes, and a compensation committee to look at the compensation of the management board. This committee may also look at the appointment of members of the management board.

The Cromme Code also states that members of the management board of a listed company should not be on more than five supervisory boards in non-group listed companies. The compensation of members of the supervisory board is specified either by a resolution of the general meeting or in the articles of association. Members of the supervisory board may receive performance-related compensation as well as fixed compensation. The compensation of the supervisory board members should be disclosed in the Corporate Governance Report.

An interesting disclosure required by the Cromme Code is that if a supervisory board member takes part in less than half of the meetings of the supervisory board in a financial year, then this will be noted in the report of the supervisory board. Any conflicts of interest should be reported to the supervisory board and the supervisory board would then inform the general meeting of any conflicts of interest together with how these conflicts have been treated.

Question 24:

(a) Discuss about the following reports on Corporate Governance:

1. **Higgs Report**
2. **Smith Report and Guidance**
3. **Combined Code, 2003 and 2006**

(c) Discuss about the importance of Financial Reporting council.

Answer:

(a)

1. **Higgs Report:**

The Higgs Review, chaired by Derek Higgs, reported in January 2003 on the role and effectiveness of non-executive directors. Higgs offered support for the Combined Code whilst making some additional recommendations. These recommendations included : stating the number of meetings of the board and its main committees in the annual report, together with the attendance records of individual directors; that a chief executive director should not also become chairman of the same company; non-executive directors should meet as a group at least once a year without executive directors being present, and the annual report should indicate whether such meetings have occurred; chairmen and chief executives should consider implementing executive development programmes to train and develop suitable individuals in their companies for future director roles; the board should inform shareholders as to why they believe a certain individual should be appointed to a non-executive directorship and how they may meet the requirements of the role; there should be a comprehensive induction programme for new non-executive directors, and resources should be available for ongoing development of directors; the performance of the board, its committees and its individual members, should be evaluated at least once a year, the annual report should state whether these reviews are being held and how they are conducted; a full time executive director should not hold more than one non-executive directorship or become chairman of a major company; no one non-executive director should sit on all three principal board committees (audit, remuneration, nomination). There was substantial opposition to some of the recommendations but they nonetheless helped to inform the Combined Code. Good practice suggestions from the Higgs Report were published in 2006.

Following a recommendation in chapter 10 of the Higgs Review, a group led by Professor Laura Tyson, looked at how companies might utilize broader pools of talent with varied skills and experience, and different perspectives to enhance board effectiveness. The Tyson report was published in 2003.

2. **Smith Report and Guidance:**

The Smith Review of Audit Committees, a group appointed by the Financial reporting council, reported in January 2003. The review made clear the important role of the audit committee: 'While all directors have a duty to act in the interests of the company, the audit committee has a particular role, acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control'. The review defined the audit committee's role in terms of a high-level overview-it needs to satisfy itself that there is an appropriate system of controls in place but it does not undertake the monitoring itself .

A new edition of the guidance was issued in October 2008. The main changes to the guidance as detailed on the FRC website are:
Audit committees are encouraged to consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning; companies are encouraged to include in the audit committee's report information on the appointment, reappointment or removal of the auditor, including supporting information on tendering frequency, the tenure of

the incumbent auditor and any contractual obligations that acted to restrict the committee's choice of auditor; a small number of detailed changes have been made to the section dealing with the independence of the auditor, to bring the guidance in line with the Auditing Practices Board's Ethical Standards [2004, revised 2008) for auditors, which have been issued since the guidance was first published in 2003; and an appendix has been added containing guidance on the factors to be considered if a group is contemplating employing firms from more than one network to undertake the audit.

3. **Combined Code, 2003 and 2006:**

The revised Combined Code, published in July 2003, incorporated the substance of the Higgs and Smith reviews. However, rather than stating that no one non-executive director should sit on all three board committees, the Combined Code stated that 'undue reliance' should not be placed on particular individuals. The Combined Code also clarified the roles of the Chairman and the Senior Independent director (sid), emphasizing the Chairman's role in providing leadership to the non-executive directors and in communicating shareholders' views to the board; it also provided for a 'formal and rigorous annual evaluation' of the board's, the committees', and the individual directors' performance. At least half the board in larger listed companies was to be independent non-executive directors.

The findings of the Financial Reporting Council (FRC) *Review of the Impact of the Combined Code* were published in December 2007. The overall findings indicated that the Combined Code (2006) had general support and that the FRC would concentrate on improving the practical application of the Combined Code.
In June 2008, the FRC published a new edition of the Combined Code which introduced two changes. These changes were (i) to remove the restriction on an individual chairing more than one FTSE 100 company; and (ii) for listed companies outside the FTSE 350, to allow the company chairman to sit on the audit committee where he or she was considered independent on appointment.
The FRC stated on their website that the revised Code took effect at the same time as new FSA Rules implementing EU requirements relating to corporate governance statements and audit committees. The revised code and new rules will apply to accounting periods beginning on or after 29 June 2008. In practice this means most companies will begin to apply them in 2009, and will report against them for the first time in 2010.

(b) The Financial Reporting Council (FRC) has six operating bodies: the Accounting Standards Board (ASB), the Auditing Practices Board (APB), the Board for Actuarial Standards (BAS), the Professional oversight Board, the Financial Reporting Review Panel (FRRP), and the Accountancy and Actuarial Discipline Board (AADB).

The importance placed on corporate governance is evidenced by the fact that, in March 2004, the FRC set up a new committee to lead its work on corporate governance.
Overall, the FRC is responsible for promoting high standards of corporate governance. It aims to do so by:

- Maintaining an effective Combined Code on Corporate Governance and promoting its widespread application;
- Ensuring that related guidance, such as that on internal control, is current and relevant;
- Influencing EU and Global Corporate Governance developments;
- Helping to promote boardroom professionalism and diversity;
- Encouraging constructive interaction between company boards and institutional shareholders.

The FRC has carried out several consultative reviews of the Combined Code which led to the amended Combined Code in 2006, and subsequently in 2008 (discussed earlier). The latest review took place in 2008. The frequency of the reviews are both an indicator of the FRC's responsibility for corporate governance of UK companies which involves leading public debate in the area and its response to the global financial crisis which has, in turn, affected confidence in aspects of corporate governance.

The FRC website mentions the independent review of the governance of banks and other financial institutions carried out by Sir David Walker. The Walker Review published its draft recommendations in July 2009, some of the recommendations could be taken forward through amendments to the Combined Code. The FRC is considering the extent to which the Walker Review recommendations may be applicable for some or all listed companies in other sectors.

Question 25:

(a) State the responsibilities that the Boards of state-owned enterprises must undertake.

(b) Discuss about the most important challenge in maintenance of good corporate governance in state-owned enterprises.

(c) What is the importance of MoU in Public sector Enterprises?

Answer:

(a) The boards of state-owned enterprises should have the necessary authority, competencies, and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

1. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The board should be fully accountable to the owners, act in the best interest of the company, and treat all shareholders equally.

2. SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.

3. The boards of SOEs should be so composed that they can exercise objective and independent judgment. Good practice calls for the chair to be separate from the CEO.

4. SOE boards should carry out an annual evaluation to appraise their performance.

(b) Conflicts of interest are a major challenge to the establishment and maintenance of good governance practices, and can occur and exist irrespective of the ownership structures. While some of the conflicts may be similar in nature, others may be typical to the type of ownership structure.

Most of the conflicts of interest in PSUs occur because of the roles played by bureaucrats and politicians in the running and management of the enterprise. For example, polticians or bureaucrats may try to have their candidate as the chairman and/or managing director in order to push through their private agendas rather than getting the best professional to run the PSU. There have also been many instances where the chairman and/or managing director, or other senior executives of the PSU has placed orders or awarded contracts at rates higher than the best prices, and earned hefty commissions on these. Orders or contracts may also be given to those who do not have the necessary capabilities to execute them. What is best for the PSU usually gets neglected. There may also be issues such as ministers or politicians yielding to recommendations of their cadre and sometimes even creating positions or designations that are not at all needed, leading the PSU to have a bloated workforce and driving it into the sick category. Politicians or bureaucrats may even harp on the flimsy reason that PSUs have employment generation as one of their aims. Most of the conflicts of interest with regret to PSUs dwell on the area of decision-making, which is very often not founded on merit.

(c) After Independence, Public Sector Enterprises (CPSEs) were set up in India with an objective to promote rapid economic development through the creation and expansion of infrastructure by the government. With different phases of development, the role of CPSEs has changed and their operations have extended to a wide range of activities in manufacturing, engineering, steel, heavy machinery, machine tools, fertilizers, drugs, textiles, pharmaceuticals, petro-chemicals, extraction and refining of crude oil and services such as telecommunication, trading, tourism, warehousing, etc. as well as a range of consultancy services. While there have been many CPSEs that have performed very well in competition with private sector enterprises, there are also many CPSEs that have performed very poorly. In an economic environment that has changed considerably in the last two decades, the role of CPSEs has changed and they have been increasingly guided to reduce their dependence on the Government. They have been listed on the stock exchange and few of them have been privatized. The Government has provided CPSEs the necessary flexibility and autonomy to operate effectively in a competitive environment. However, there are a few issues with the operation and management of CPSEs which still persist and need to be attended to. There is a need to develop a mechanism on how government can get an efficient Indian presence in the sectors where the private sector investments are not forthcoming especially in strategic areas where developing capabilities is essential if India has to play its rightful role among the among the nations of the world.

Question 26:

(a) Discuss about the major developments in governance in India in the last decade.

(b) "MoU in India'. Comment.

Answer:

(a) The Indian economy, on the Twelfth Plan is characterized by strong macro-fundamentals and good performance over the Eleventh Plan period, though clouded by some slowdown in growth in the current year with continuing concern about inflation and a sudden increase in uncertainty about the global economy. The objective of the Eleventh Plan was faster and inclusive growth and the initiatives taken in the Eleventh Plan period have resulted in substantial progress towards both objectives. Inevitably, there are some weaknesses that need to be addressed and new challenges that need to be faced. Some of the challenges themselves emanate from the economy's transition to a higher and more inclusive growth path, the structural changes that come with it and the expectations it generates. There are external challenges also arising from the fact that the global economic environment is much less favourable than it was at the start of the Eleventh Plan. These challenges call for renewed efforts on multiple fronts, learning from the experience gained, and keeping in mind global developments.

The focus on the backdrop of target setting and areas of focus of the Eleventh Plan. India entered the Eleventh Plan period (2007-2012) with an impressive record of economic growth. The vision for the Eleventh Plan prominently included an improvement in governance. Over the years, the governments at the Centre and the States have launched a large number of initiatives at substantial public expense to achieve the objectives of growth with poverty alleviation and inclusiveness. Experience suggests that many of these initiatives have floundered because of poor design, insufficient accountability and also corruption at various levels. Increasingly, there is demand for effective implementation without which expanded government intervention will be infructuous. The strategy for the Eleventh Plan was therefore aimed at bringing about major improvements in governance which would make government-funded programmes in critical areas more effective and efficient. The best possible way of achieving this objective may be by involving communities in both the design and implementation of such programmes, although such involvement may vary from sector to sector. For achieving the vision of the Eleventh Plan, it is extremely important to experiment with programme design to give more flexibility to decision making at the local level. It is especially important to improve evaluation of the effectiveness of how government programmes work and to inject a commitment to change their designs in the light of the experience gained. Evaluation must be based on proper benchmarks and be scientifically designed to generate evidence-based assessment of different aspects of programme design. Along with greater transparency and feedback from community participation, this is particularly important in the case of programmes delivering services directly to the poor. Accountability and transparency are critical elements of good governance. The Right to Information Act (RTI) enacted in 2005 empowers people to get information and constitutes a big step towards transparency and accountability.

(b) Notwithstanding the spectacular performance of CPSEs in several areas, there has been a sense of disillusionment with some aspects of CPSE performance such as low profitability and lack of competitiveness. The extensive regulation of CPSEs by government had stifled the initiative and growth of public sector. The Economic Administration Reforms Commission (Chairman: L. K. Jha) had dwelt on issue of autonomy and accountability. The Commission had recommended a careful re-consideration of extant concepts and instrumentalities relating to the accountability of public enterprises with a view to ensuring (a) that they do not erode the autonomy of public enterprises and thus hampers the very objectives and purposes for which these enterprises have been set up and given corporate shape and for which they are to be accountable; and (b) accountability has to be secured in the wider sense of answerability for the performance of tasks and achievements of results (EARC-II/Report No. 4, p. 22). The adoption of MoU system in India could be seen as an attempt to operationalize this very vital recommendation.

STUDY NOTE 9 – SOCIAL, ENVIRONMENTAL AND ECONOMIC RESPONSIBILITIES OF BUSINESS:

Question 27:

(a) State with reasons -whether the following statements are correct or incorrect:
"Corporate Social Responsibility is closely linked with the principles of sustainable development."

(b) "In a highly competitive and surcharged environment, family-owned concerns are changing for the better."
In view of the above statement, discuss some of the factors responsible for such a change.

Answer:

(a) World Business Council for Sustainable Development defines Corporate Social Responsibility as follows:
"Corporate social responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large."

CSR advocates moving away from a 'shareholder alone' focus to a 'multi-stakeholder' focus.
Sustainable Development is 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs'.

A business organisation which employs eco-friendly business practices is, no doubt, socially responsible as it takes into account the interest of its stakeholders, viz. the environment and the society at large. As a corollary, a business organisation which is socially responsible would, no doubt, employ eco-friendly business practices.

Only a business organisation which is conscious of its duty towards the environment would employ eco-friendly business practices and adopt the principles of sustainable development.
Thus, it is correct to say that "Corporate Social Responsibility is closely linked with the principles of sustainable development".

(b)

1. <u>Market forces and competition force professionalisation:</u>

Family concerns will turn professional in order to face successfully competition and market forces. This does not imply that family-owned business will come to an end, but the demarcation between ownership andcontrol, on the one hand, and management on the other, will be much more evident.

2. <u>Independent directors will have a say:</u>

Members of the board will be persons with technical and managerial capabilities "Who can guide and oversee operating management in the discharge of their functions". The boards will have a number of (upto 50 per cent) independent external directors who can advise, admonish and control operating management, without fear or favour, on issues of policy and performance.

3. <u>The topmen will not wear two hats:</u>

The practice of one person combining in himself both the positions of Chairman and CEO will sooner rather than later, come to an end.

4. <u>Emergence of board committees:</u>

Boards delegating specific tasks such as audit, remuneration and appointments to committees with members having professional expertise will be a normal phenomenon.

5. <u>Transparency in reporting and full financial disclosures:</u>

Transparency in reporting and full disclosures will be norms. The board has to ensure adoption of appropriate accounting standards in the preparation of company's accounts and material changes during the financial year are fully discussed and justified.

6. <u>Independent and competent auditors will do their jobs:</u>

Guidelines on corporate governance all over the world insist on independence of audit, and this will be observed by boards in India too. Boards will have to ensure unattached and professionally competent auditors to audit the company's accounts.

7. <u>Long term stakeholder interests will be ensured:</u>

The highest priority of the boards would be to ensure long-term maximisation of shareholder value and wealth. Better corporate performance through legitimate and transparent policies will enrich shareholders. Accountability to shareholders does not mean, however, that other stakeholders such as customers and employees would have to be excluded, as the respective objectives are not naturally exclusive.

8. <u>Board's members' commitment ensured through adequate compensation:</u>

Since boards will have to shoulder greater responsibility, bear risk and manage uncertainty with a great deal of pressure on them to perform, both from internal and external sources, their members would have to be compensated adequately and appropriately.

9. <u>Boards will be committed to corporate social responsibility:</u>

Corporate social responsibility would become part and parcel of the duties of boards of directors. They who draw so much from the society in terms of resources, trained manpower, law and order, public health, infrastructure and well-developed markets to do their business and make profits, have a moral and social responsibility to share with the society at least a part of what they earn and gain, by their ethical practices and catering to the basic needs of communities they operate-in, supplementing wherever possible, the efforts of public authorities. "Corporates would have to provide demonstratable evidence of their concern for the issues that confront those constituencies.

10. <u>Whistle blower policy will be in place:</u>

Companies would in due course put in place an appropriate whistle blower policy enabling both the board and senior management takes corrective measures to stem the rot, if any, in good time. Through SEBI under listing agreement (LA) with stock exchanges made whistle blower policy in the revised clause 49 non-mandatory, corporate governance advocates point out that sooner than later the Indian regulator would be prompted to make mandatory the whistle blower policy through which a company might establish a mechanism for employees to report to the management concerns about unethical behavior, actual or suspended fraud, or violation of the company's code of conduct or ethics policies.

<u>Question 28:</u>

(a) Explain briefly the key strategies which can be used at the time of implementation of Corporate Social Responsibility policies and practices in a company.

(b) State the relationship between globalization and CSR.

Answer:

(a) The various strategies which may be used at the time of implementation of CSR policies and practices in a company are:

1. Top management initiative:

- The attitude of top management towards CSR can determine whether or not an entity would actually carry out CSR measures. The top management can provide strong and visible support for the entity's commitment towards CSR by incorporating CSR measures in entity's Mission, Vision and Values statements.
- The Mission, Vision and Values statement of a socially responsible business should go beyond 'making profit' and specify that the entity will -
  1. engage in ethical and responsible business practices; and
  2. Promote the interests of all the stakeholders.

2. Integration of CSR in decision making:

- CSR is viewed as a comprehensive set of policies, practices and programs that are integrated into decision-making processes throughout the organisation. Therefore, an entity should incorporate CSR initiatives in its core business operations and strategies.
- The organisation should set specific goals for CSR.
- At the stage of planning, the organisation should lay down the measures for evaluating the progress from time to time.
- As far as possible, the goals should be laid down in quantifiable terms.

3. Management Structure:

- To promote the achievement of its CSR objectives in a more effective manner, an entity should integrate CSR measures in all its operations and business decisions.
- An entity may establish a CSR Committee and other related or sub-committees for promotion and enforcement of CSR. The functions of the CSR Committee should be to identify and evaluate the key CSR issues, and to integrate the key CSR issues in all the functions of management.
- The issues that represent a company's CSR focus vary by nature of business, by size, by sector and even by geographic region. Therefore, there cannot be a universally accepted management structure for promotion of CSR Thus, it has been rightly said, and "Creating a CSR structure is not a 'one size fits all' exercise.

4. Accountability for CSR in job profiles:

- An entity should clearly fix the responsibilities of its managers and employees for promotion and achievement of CSR objectives.
- The job profiles and job descriptions of each manager and employee should be customised to include the guidelines, examples and tools that fit his level of commitment and involvement in CSR.

5. Employee recognition and rewards:

- Employees tend to engage in behaviour that is recognized and rewarded and avoid
- behaviour that is penalised.

- An entity should implement a 'Reward Program' for recognising and rewarding those managers and employees who have contributed towards successful implementation of CSR measures or activities. This would act as a strong motivating force for the workforce to contribute towards entity's CSR objectives.
- The Reward Program may be in the nature of publication of a magazine periodically, including therein the highlights of CSR measures undertaken by the employees, or awarding the employees with letters of appreciation, certificates for excellent performance or small gifts like T-Shirts, mugs, pens, or giving them direct or in direct financial assistance.
- Also, the entity should participate in the award ceremonies organised at State and National level for recognising and rewarding those entities and individuals who have contributed towards CSR

6. <u>Recruitment and promotion policies:</u>

- The recruitment and promotion policies of the entity should clearly highlight the entity's commitment towards CSR.
- The CSR activities undertaken by the managers and employees should carry appropriate weightage at the time of recruitment, selection and promotion.

7. <u>Training programs:</u>

- The entity should regularly conduct comprehensive training and development programs emphasising the importance of CSR.
- The employees should be trained about their roles in implementation of CSR measures and attainment of CSR objectives.
- The training program should serve as a vehicle for sharing experiences and a source for learning and developing best practices throughout the entity. It should serve as an inspiration for continuous improvement.
- Proposals and initiatives by the employees should be welcome and the entity should provide necessary facilities for implementation of all such CSR measures or activities that are in line with entity's CSR objectives.

8. <u>Implementation of CSR:</u>

- CSR requires an entity to integrate social, environmental and ethical concerns into its business process. Therefore, just like any other business function, CSR performance and compliance should also be subject to review and control.
- If CSR performance is neither measured nor rewarded, the employees commitment towards CSR would come down, and the stakeholders would conclude that CSR is of secondary importance.

9. <u>Influencing others to be socially responsible:</u>

- An entity which is, and is recognised by others as, socially responsible, is in a position to influence the behaviour of others, from business partners to industry colleagues to neighbouring businesses. Such entity should play a leadership or pioneer role by sharing its experiences with others and, encouraging others, to be socially responsible.
- An entity, by influencing others to be socially responsible, performs CSR as it is in everyone's best interest to have as many persons as possible honouring the requirements and expectations of CSR.

10. <u>CSR reporting and audit:</u>

- An entity should regularly publish CSR Reports. It would help the entity to build and reinforce trust with all the stakeholders. The CSR Reports should be aimed at increasing the awareness and importance of CSR.
- CSR reports should highlight the CSR activities undertaken by the entity, the employees who played a key role in achievement of CSR initiatives.
- CSR reporting reflects that the top management is serious about its commitment towards CSR, and that CSR is not used just for name sake, or for building image.
- An entity may also decide to obtain an independent third party verification of the CSR report. Alternatively, it may get CSR Audit done by external auditors and publish the results of such audit.

(b) Globalisation and CSR:

As a consequence of cross-border trade, multinational enterprises and global supply chains, there is an increased awareness on CSR concerns related to human resource management practices, environmental protection, and health and safety, among other things. Reporting on the CSR activities by corporates is therefore increasingly becoming mandatory.

In an increasingly fast-paced global economy, CSR initiatives enable corporates to engage in more meaningful and regular stakeholder dialogue and thus be in a better position to anticipate and respond to regulatory, economic, social and environmental changes that may occur.

There is a drive to create a sustainable global economy where markets, labour and communities are able to function well together and companies have better access to capital and new markets.

Financial investors are increasingly incorporating social and environmental criteria when making decisions about where to place their money, and are looking to maximise the social impact of the investment at local or regional levels.

Question 29:

(a) Discuss the steps involved in the whole life-cycle risk process for each stage of the project.

(b) How do asset characteristics influence computation of WLCC?

Answer:

(a) The framework, integrating the five iterative steps, is explained in the following sections:

1. Whole life risk identification:

The process starts with a qualitative stage that focuses on identification of risks related to each of the whole life-cycle processes. Risks that are unidentified and not quantified are unmanaged risks that can have a significant negative outcome on projects and organisations. If any of the unidentified risks occur at any stage of the project life-cycle, this may have serious consequences on stakeholders‟ financial status. Hence, perhaps the most important step in the whole life-cycle risk process is the process of risk identification. The quality of this process has a direct effect on the quality and accuracy of risk analysis, quantification, and development of risk strategy responses, and on the management of risk throughout the life span of projects. The output of risk identification will inform the second quantitative analysis process that focuses on evaluation and assessment of risks associated with each aspect of the life-cycle span of projects.

2. Whole life risk analysis:

Several methodologies are available to deal with WLCC risk analysis. The techniques that can be used in WLCC risk assessment decision making might be summarised as deterministic, probabilistic and AI. Deterministic methods measure the impact on project outcomes of changing one uncertain key value or a combination of values at a time. In contrast, probabilistic methods are based on the assumption that no single figure can adequately represent the full range of possible outcomes of a risky investment (Fuller & Petersen 1996). Rather, a large number of alternative outcomes must be considered and each possibility must be accompanied by an associated probability from a probability distribution, followed by a statistical analysis to measure the degree of risk. Using a deterministic approach, the analyst determines the degree of risk on a subjective basis. All methods differ from the above approaches and use historical data to model cost and uncertainty in WLCC analysis. None of these techniques can be applied to every situation. The best method depends on the relative size of the project, availability of data and resources, computational aids and skills, and user understanding of the technique being applied.

3. Whole life risk responses:

Developing responses to reduce WLCC risks is the third step in the integrated WLCC risk management framework. Once the building assets and the many different risks and threats to which they are exposed are identified and quantified and the related life-cycle vulnerabilities assessed, necessary steps should be taken to ensure that the entire investment is protected from all sources of external and internal threats. Thus, the third stage is concerned with the identification of strategies that mitigate the effect of anticipated threats to the greatest extent possible. This should be based on the following universal rules: risk avoidance, risk reduction, risk absorption and risk transfer.

4. Whole life risk management plan:

Following the identification, quantification and development of risk responses, the related vulnerabilities of building assets need to be determined and planned for. This provides the basis on which risk management plans and decisions are made. The risk management planning process is concerned with putting in place the procedure for:

- What response actions are needed?
- When these response actions are needed?
- How these actions are implemented?
- Who is responsible for the implementation, control and monitoring of the actual progress of risk responses and management strategies that have been developed to deal with the identified risk?

5. Whole life risk monitoring and feedback:

The issue of risk monitoring is essential for ensuring effective implementation of risk control measures. Active risk monitoring ensures that effective response measures to manage the risks are appropriately implemented. Since we are dealing with the life-cycle of projects, the initial decision conditions may change over time, which could lead to the change of risks. Hence, a feedback and continuous assessment of risk through the entire life span of the project is very important in the process of whole life-cycle costing. This process should include tracking the effectiveness of the planned risk responses, reviewing any changes in priority of response management, monitoring the state of the risks, updating the whole life-cycle analysis accordingly and reviewing the economic performance indicators to check whether the investment decision is still valid or otherwise. In this way risk monitoring not only evaluates the performance of risk response strategies but also serves as a continuing feedback or audit mechanism.

The application of the above framework should take place during the early stages of asset development as well as at every project milestone, and should continue throughout the whole life of the asset. The information generated from the WLCC risk management framework should inform decision makers on which input data has the most impact on the
WLCC result and how robust the final decisions are.

(b) The characteristics (i.e. physical and functional) of new or existing facilities are very important aspects of WLCC computation. The research community has largely ignored this aspect of WLCC. For example, a relationship may exist between building function and mechanical services costs, a particularly important feature of modern facilities. Little research has been published with regard to the impact of building characteristics on WLCC. Experience shows that an indirect link exists through many aspects, including energy costs for example. A poorly insulated building will consume more energy, thus increasing WLCC and possible downtime costs in maintenance (Department of Industry 1977). The characteristics that should be assessed and included in the computation of WLCC include:

- Layout and location
- Functionality
- Construction technology
- Gross floor area
- Number of storeys and storey height
- Glazing area
- Occupancy (m2/person)
- Shape of the facility
- Aesthetics
- Energy-saving measures
- Quality of components
- Type and quality of public health systems
- Type and quality of superstructure building fabric
- Type and quality of internal fabric
- Type and quality of electrical and mechanical services
- Extent of site works.

<u>Question 30:</u>

(a) Why should Corporate Social Responsibility (CSR) look beyond the concept of philanthropy?

(b) “Corporate Citizenship: A new way to market CSR?” Comment.

<u>Answer:</u>

(a) Corporate Social Responsibility (CSR) is a management concept where good business is not only seen as maximization of shareholder value but also of stakeholder value. It is about the management of a company’s impact on its stakeholders, the environment, and the community in which it operates. It is more than just a philanthropic activity for some charitable causes. It is about the integrity with which a company governs itself, how it fulfills its mission, the values it has, what it wants to stand for, and how it engages with transparency. Here, the corporations have to move beyond the financial bottom-line to the social and environmental bottom line.

Corporate philanthropy is certainly a piece of the CSR puzzle. The thing to understand here is that it is just that: a piece. CSR and corporate philanthropy are often viewed as interchangeable terms because many of the most basic CSR efforts are philanthropic in nature. However, CSR encompasses more than corporate giving. CSR programs take a proactive approach to reduce negative impacts and increase positive impacts on the people and environment the corporation touches. For eg., a partnership with a non-profit organization can mean more than giving a hefty annual donation, joining as a corporate member, or sponsoring events. In a CSR program, a true partnership might mean encouraging employees to volunteer their time, hosting public awareness and educational events, or contributing services that are useful to the organization.

Corporate Social Responsibility looks beyond the interests of traditional stakeholders and considers impacts on employees, customers, vendors, suppliers, communities, and the natural environment. This approach to business strategy takes the minimum expected efforts, such as compliance with regulations and managing obvious risks, and goes a step further all within a thoughtfully developed and well organized program that aligns with the company's strategic plan.

CSR goes beyond philanthropy. It has to take into account integrity and accountability in the long-run process of sustainability. For a better understanding of this concept, it has been divided into four broad aspects of CSR:

- Responsibility
- Accountability
- Sustainability
- Social contact

Responsibility:

William Frederick (1994) has taken the concept of CSR to a higher level by discussing about corporate responsiveness. According to him, corporate social responsiveness refers to the capacity of a corporation to respond to social pressures. Ethically accepted corporate activity and profit-making are not mutually exclusive. Sustainable growth and success demands ethicality in the process of dealing with stakeholders. Often, CSR has been challenged on the grounds of relativity, which means that what may be considered right by one may be considered wrong by another. Arriving at a consensus for CSR checklists may not be easy.

Accountability:

The easiest way to understand the different levels of accountability is to adhere to the report on Social Responsibilities of Business Corporations issued by the Committee for Economic Development (CED) in 1971. The report consists of the three concentric circles: Inner Circle, Intermediate Circle and Outer Circle. CSR includes integrity and accountability because it demands knowledge that goes beyond the traditional framework of business understanding, i.e., profit-making and bottom line.

Sustainability:

Sustainability places an extended set of expectations on business. Such issues as layoffs, plant closures, product quality, financial frauds, or industrial pollution demand the consideration of a diverse and complex range of systematic solutions. The reason CSR has to promote beyond philanthropy is because familiarity with unethical practices often makes society extremely tolerant and insensitive. The objectives of a company's CSR governance must be clearly defined with respect to its different stakeholders. The business environment will always be in a continuous state of flux due to the influence of socio-economic and political changes in the micro and the macro level. Therefore, CSR needs a strategy that needs to uphold the ethical standards.

<u>Social Contract:</u>

CSR is related to the social contract between the business and the society in which it operates. At any one time in any one society, there is a set of generally accepted relationships, obligations, and duties between the major institutions and the people. Though business has the bigger responsibility of going beyond philanthropy, one must also keep in mind that each stakeholder also has reciprocal duties with others and the consuming community also has the obligation to make the tradeoff between cost and sustainability and integrity. Different stakeholders also cannot be driven by their selfish interests alone because each stakeholder has an important role to play and one cannot be destroyed for the benefit of the other.

(b) A new terminology that has been gaining grounds in the business community today is Corporate Citizenship. We need to understand the concept of corporate citizenship and how is it fundamentally different from corporate social responsibility. Corporate citizenship is defined by the Boston College Centre for Corporate Citizenship, as the business strategy that shapes the values underpinning a company's mission and the choices made each day by its executives, managers and employees as they engage with society.

According to this definition, the four key principles that define the essence of corporate citizenship are: (i) Minimise harm (ii) Maximise benefit (iii) Be accountable and responsive to key stakeholders (iv) Support strong financial results.

Thus, corporate citizenship, similar to its CSR concept, is focusing on the membership of the corporation in the political, social and cultural community, with a focus on enhancing social capital. Notwithstanding the different terminologies and nomenclature used, the focus for companies today should be to focus on delivering to the basic essence and promise of the message that embodies these key concepts – CSR and Corporate Citizenship.